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WHAT THE NEW CBO PROJECTIONS MEAN

Can the New Surplus Projections Accommodate a Large Tax Cut?

By Robert Greenstein and Richard Kogan

Today the Congressional Budget Office released its new budget forecast, in which it projects a noticeably larger 10-year surplus than it had last year. Some pundits and policymakers have concluded that this increase indicates there is plenty of room for a very large tax cut — as large as or larger than President Bush proposed in his campaign.

As is often the case with budget forecasts, first impressions can be deceptive. This report examines two issues:

- How much of the surplus excluding Social Security is actually available for tax cuts and program initiatives?
- How does the potentially available non-Social Security surplus compare with the size of the tax cut that President Bush proposed in his campaign?

Under the new CBO forecast, the projected surplus excluding Social Security is $3.1 trillion over 10 years. (The Clinton Administration issued an estimate of $2.4 trillion on January 16.) However, as earlier analyses by the Center on Budget and Policy Priorities, the Brookings Institution, and the Concord Coalition all have explained, there is a difference between CBO's estimate of the size of the non-Social Security surplus and the amount that actually is available for tax cuts and program initiatives.

In making its surplus estimates, CBO follows certain rules under which it assumes that various tax increases and program reductions that neither party favors — and that are very unlikely to take place — will go into effect. Furthermore, CBO includes the temporary surpluses building in the Medicare Hospital Insurance trust fund in its estimate of the non-Social Security surplus. Both chambers of Congress voted last year by large bipartisan margins to set these Medicare surpluses to the side and not use them to finance tax cuts or program increases.

Setting the Medicare surpluses to the side — and using the more prudent and more realistic assumption that the tax increases and program reductions reflected in the CBO projections will not occur — produces an estimate of the *available* surplus that is about $1.1 trillion lower. This leaves an available surplus of $2.0 trillion over the next 10 years.

Bush Administration Opposes Setting Aside Medicare Surplus

Apparently, the Bush Administration opposes setting aside the Medicare surplus. On January 30, White House press spokesman Ari Fleischer said the Administration supported setting aside only the Social Security portion of the surplus, not the Medicare HI portion. Fleischer portrayed the Administration position as favoring the use of the Medicare portion of the surplus for a prescription drug benefit. The actual effect of such a move would be to enlarge the amount of resources that could be spent on the overall Bush plan, including the Bush tax cut. The motivation here appears to be to find more resources for a tax cut that, as explained below, is now rising substantially in cost.

The Congressional purpose in setting aside the Medicare HI surplus is to preserve those surpluses for the future needs of the Hospital Insurance Trust Fund, which will increase as the baby boom generation turns 65 and becomes eligible for Medicare. If, instead, those surpluses are used for a new prescription drug benefit that is financed on an ongoing basis out of the Medicare HI trust fund, the surpluses in that fund will not be available to cover the future hospitalization costs of Medicare beneficiaries.

An available surplus of $2.0 trillion over 10 years is itself a large number. But there are three reasons it would be ill-advised for the new Congress and Administration to use all of this amount. First, the $2.0 trillion estimate of the available surplus is only a projection. Any number of events — such as slower-than-forecast economic growth or faster-than-expected growth in health care costs — could cause these projections to be too high. As both CBO and OMB have pointed out, their own historical track records show that their budget projections are subject to considerable error, even in the short term. In fact, they believe it is well within the range of possibility that there will be *no* surpluses over the next ten years, outside of Social Security and Medicare. If the full amount of the projected surplus (excluding Social Security and Medicare) is consumed by actions that Congress and the President take in the coming year or two but the projections later prove to have been too optimistic, sizable deficits (excluding Social Security and Medicare) could return.

A second reason that it would be unwise to consume all of the $2.0 trillion available surplus is that even if the surplus forecast proved correct, acting now to commit all of the available surpluses for the next 10 years would leave no funds available for subsequent Congresses to use to address needs that cannot be foreseen but inevitably will arise. It is inconceivable that no such needs will emerge over the course of the decade. Such needs could be military, international, or domestic. While we cannot know today what these needs will be, we can count on some new problems emerging that will have to be addressed.

A final reason that consuming all of the projected $2.0 trillion would be imprudent relates to Social Security and Medicare. If legislation to restore long-term Social Security solvency is to be enacted, a transfer of non-Social Security, general revenues from the Treasury to the Social Security Trust Fund (or to private, individual retirement accounts) almost certainly will be required. Without such a transfer, the magnitude of the reductions in retirement benefits that would be required — regardless of whether a solvency plan includes individual accounts — would almost surely make the plan impossible to pass. As a result, policymakers ought to set aside, or reserve, a portion of the projected non-Social Security surplus funds for this purpose. Earlier Center analyses estimated that to be prudent, a minimum of $500 billion over 10 years should be reserved for this purpose. (Any claim that this problem can be addressed without a transfer of funds because the projected Social Security surpluses can be used to shore up the Social Security system would be spurious; the Social Security surpluses already are taken into account in the Social Security trustees' estimate that the program will become insolvent in the late 2030s. Addressing the solvency problem entails reducing Social Security benefits or increasing revenues to the Social Security system.)

Where the Bush Tax Cut Fits In

This report therefore cautions that when realistic assumptions are employed, the available surplus outside Social Security and Medicare is likely to be about $2.0 trillion over 10 years and that at least $500 billion of this amount should be reserved for Social Security solvency purposes. The report also advises that some portion of the remainder should be set aside both as a hedge against the possibility that the surplus forecast may prove too optimistic and as a reserve for needs that will emerge in future years. This brings us to the question of how the tax cut that President Bush proposed in the campaign measures up against this standard. That tax cut was the largest budget initiative the President proposed, although he also proposed a prescription drug benefit for seniors, other health care initiatives, increases in education spending, and a national missile defense, among other items.

During the course of his campaign, President Bush said his tax cut would cost $1.3 trillion over 10 years. Some media accounts continue to cite this figure, although more now cite a figure of $1.6 trillion. Properly measured, however, the Bush tax cut would consume $2.1 trillion over the next 10 years.

The $1.3 trillion figure comes from an estimate the Congressional Joint Committee on

CBO Assumes Economy Will be *Stronger* Than It Earlier Forecast and Rebound Fully from the Current Slowdown Without a Tax Cut

The new CBO forecast projects a larger surplus than CBO projected last July for one overriding reason: CBO now believes the economy will be stronger over the next 10 years — i.e., will grow at a faster rate — than CBO projected six months ago. CBO projects that while economic growth will slow in 2001 and rise at a rate of 2.4 percent of GDP (after adjusting for inflation), the economy then will rebound and grow at a rate of 3.4 percent in 2002 and a rate of 3.1 percent throughout the rest of the 10-year period.

CBO forecasts that this rebound and higher subsequent growth rate will occur without any tax cut. The CBO report casts doubt on claims that a proposal such as the Bush tax cut, the vast bulk of the costs of which would occur *after* the current slowdown is long over, is needed to address problems of a weak economy. Moreover, if one believes the economy will remain weak for much of the next 10 years, then one essentially believes much of the projected surplus will never materialize. It is inconsistent to maintain both that a permanent, backloaded tax cut is needed to address problems of a weak economy and that the new surplus forecast means a very large tax cut can be accommodated.

Taxation (JCT) produced last spring of the cost of the Bush tax cut over the 10 years *from 2001 to 2010*. (This JCT estimate did not include the approximately $100 billion cost of health care insurance-related tax provisions that were proposed by candidate Bush after his tax plan was announced. This Center analysis similarly does not include the effect of those proposed health care insurance-related tax cuts; their costs are in addition to the costs cited here.) Because the Bush tax cut would not take effect until 2002, the Joint Committee on Taxation estimate showed it had no cost in the first year (2001), making the $1.3 trillion figure essentially a nine-year cost estimate. However, the new surplus projections — and all of the budget figures the new Congress and President will use — cover the 10-year period *from 2002 through 2011*. A simple extrapolation of the Joint Committee on Taxation estimate indicates that reflecting this additional year increases the cost of the Bush tax cut by more than $240 billion, bringing to $1.6 trillion the figure increasingly cited as the tax cut's cost.

Even this number is artificially low. In its calculations of the tax cut's cost, the Joint Committee on Taxation had to assume that Congress would fail to address a well-known problem of current law — that if nothing is done, the Alternative Minimum Tax will encroach more heavily each year upon the middle class, subjecting millions of middle-class taxpayers to greatly increased tax complexity and greater tax burdens than they otherwise would face. Because President Bush did not include a measure to address this problem in his tax plan,[1] JCT had to assume the AMT would invade the middle class in coming years. No knowledgeable observer, however, expects Congress to stand idly by and allow millions of middle-class families to become subject to the AMT. Joint Tax Committee analyses show that if the AMT problem is addressed, as it surely will be, the cost of the Bush tax cut increases by about another $200 billion. This is because the cost estimate of the Bush tax plan that the Joint Tax Committee produced assumed that a swelling AMT would cancel out part of the tax reduction the tax cut otherwise would provide.

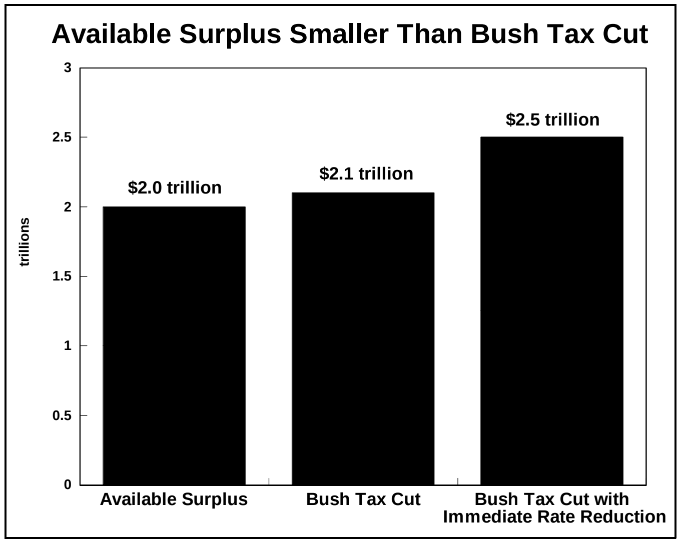
Finally, in assessing the amount of the budget surplus that is eaten up by any tax cut or spending increase, one must include the cost of the increased interest payments that would have to be made on the national debt. Since the surplus would be used for tax cuts rather than to pay down the debt, the overall size of the debt would be larger than would otherwise have been the case, and annual interest payments on the debt would be correspondingly greater. The Bush tax cut would result in additional interest payments on the debt of approximately $400 billion over 10 years.

Reflecting these higher interest payments brings the total 10-year cost of the Bush tax cut to $2.1 trillion, an amount that exceeds the available surplus excluding Social Security and Medicare. (The $2.1 trillion figure includes the higher costs that will result when the AMT problem is addressed.) It should be noted that this figure does not reflect the additional costs that

[1] The Bush tax proposal changes the AMT only with respect to the child tax credit (both the existing credit and the President's proposed increase in the credit).

will result if, as is reported to be the case, the Administration proposes accelerating some of its proposed tax cuts so they take effect sooner. If the Bush tax plan is modified so its reductions in tax rates take full effect now rather than being phased in through 2006, the plan's cost rises another $400 billion (including the added interest payments on the debt) to $2.5 trillion. Costs for other Bush Administration proposals in areas such as prescription drugs and health insurance (including health insurance-related tax cuts), as well as the costs of other initiatives that Congressional majorities may favor — including additional tax cuts — would be on top of this.

Figure 1



This analysis now proceeds to examine in more detail the two questions set forth above: How much of CBO's newly projected surplus is realistically available; and how much of the projected surpluses would the Bush tax cut consume?

Federal Spending Projected to Reach Record Lows as a Share of the Economy

CBO's new baseline projections show that in coming years, both total federal spending and spending on appropriated programs (discretionary programs) will decline to historically low levels as a share of the economy.

Specifically, CBO shows total federal spending declining from 18.2 percent of the Gross Domestic Product (GDP) in 2000 to 15.1 percent in 2011. Last year's level — 18.2 percent of GDP — was already the lowest level of federal spending since 1966. If it declines to 15.1 percent by 2011, as CBO projects, federal spending would be the smallest share of the economy since 1951. In no year since 1956 has federal spending been lower than 17.0 percent of GDP.

The projections for appropriated spending are equally striking. Under CBO's new projection, appropriations are projected to decline from 6.3 percent of GDP in 2000 to 5.1 percent in 2011. The 6.3 percent figure for 2000 was already the lowest on record, going back to 1962 (the first year for which these data are available), when appropriations constituted 12.7 percent of GDP. Appropriations did not fall below 7.0 percent of GDP until 1997. In part, the steep decline in appropriated spending reflects the end of the Cold War and the resulting decision to reduce the size of the armed forces. But under CBO's new projections, *nondefense* appropriations would fall by 2011 to the lowest share of the economy on record, going back to 1962.

I. CBO's New Projections, Adjusted for More Realistic Assumptions

Reports released last year by the Center on Budget and Policy Priorities, the Brookings Institution, and the Concord Coalition explained that when CBO follows the "budget baseline" rules laid out in the Balanced Budget and Emergency Deficit Control Act, it produces surplus projections that understate the true costs of maintaining current policies and consequently overstate the magnitude of projected surpluses.[2] More realistic, but still conservative, assumptions about the cost of maintaining current policies would reduce the amount available under CBO's forthcoming projections of the non-Social Security surpluses over 2002 through 2011 by about $700 billion.

In addition, last year Congress voted by large majorities to set aside the Medicare portion of the surplus. When the Medicare portion of the surplus is set to the side, as large majorities in Congress evidently believe it should be, the size of the available surplus over this period declines by about another $400 billion. Finally, a minimum of $500 billion is likely to be needed as part of proposals to restore long-term Social Security and Medicare solvency.

Adjustments to Reflect the Full Costs of Maintaining Current Policies

Following the baseline rules leads CBO to understate the costs of maintaining current policies in the following ways:

A. Discretionary Spending. The baseline rules call for projecting the amount of "discretionary" spending (i.e., spending for non-entitlement programs, including virtually all of the defense budget, most international programs, and a large number of domestic programs) by assuming that appropriations for non-entitlement programs will be maintained in the years from 2002 through 2011 at the level provided for fiscal year 2001, adjusted for inflation. For this assumption to prove accurate, however, discretionary spending would have to decline in purchasing power on a per-person basis in coming years (since the U.S. population will continue to grow), even in the face of budget surpluses. As the Center, the Concord Coalition, and a Brookings paper by Alan Auerbach and William Gale have noted, such an assumption almost certainly understates the likely path of discretionary spending. This is a point that former CBO directors Robert Reischauer and Rudolph Penner also have emphasized.

The discretionary appropriations levels recently enacted for fiscal year 2001 themselves exceed the amount required to keep pace with inflation by nearly $25 billion, or four percent. Moreover, between 1990 and 2000, when the primary budget emphasis was on reducing deficits,

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[2] See, for instance, James Horney and Robert Greenstein, *How Much of the Enlarged Surplus is Available for Tax and Program Initiatives?*, Center on Budget and Policy Priorities, July 7, 2000 and James Horney, "How Much of the New CBO Surplus is Available for Tax and Program Initiatives?," Center on Budget and Policy Priorities, July 18, 2000; see also Alan J. Auerbach and William G. Gale, "How Big is the Prospective Budget Surplus?," Brookings Institution, September 2000; and the Concord Coalition, "Concord Coalition Releases Issue Brief Describing How Bush and Gore Rely on a Surplus Field of Dreams," October 11, 2000.

non-defense discretionary spending grew 20 percent faster than inflation. Reductions in defense spending stemming from the end of the Cold War held down the growth of total discretionary spending during this period, but it is unlikely that defense spending will grow at a rate lower than inflation over the coming decade. Both major-party presidential candidates called for defense spending increases.

In recent years, the Center has used an alternative assumption for projecting discretionary spending that maintains appropriations at the current-year level, adjusted for inflation *and* population growth. Under this assumption, discretionary spending is assumed to remain constant in real (i.e., inflation-adjusted) terms on a per-person basis, rather than to be cut. (Note: During the Presidential campaign, President Bush said on several occasions that the appropriate baseline for measuring changes in government spending in Texas that occurred during his tenure there was a baseline that adjusted for both inflation and population growth). Using this approach results in an estimate that discretionary spending is about $300 billion higher for the 2002-2011 period than CBO projects.

Although assuming that real, per-capita discretionary spending is held constant is far more realistic than assuming this spending will keep pace only with inflation, this alternative assumption itself is likely to understate the actual path of discretionary spending. Robert Reischauer has written that "in an era of surpluses, it will be a Herculean feat" just to hold real, per-capita discretionary spending constant over a 10-year period. Reischauer, William Gale, and Alan Auerbach have argued that a more realistic assumption is that discretionary spending will grow at the rate of the U. S. economy (in other words, that it will stay constant as a share of the Gross Domestic Product).

Over the last three years, total discretionary spending has, in fact, grown faster than inflation and population; it has grown at about the same rate as the economy, as measured by gross domestic product (GDP). In addition, over the past 14 years, non-defense discretionary spending has grown at essentially the same rate as GDP. Assuming that future discretionary spending will grow at the same rate as GDP would add $600 billion in discretionary spending to the projection over 10 years, over and above the amount projected based on the assumption that discretionary spending will grow at the rate of inflation plus population growth. Although this assumption is probably more realistic than assuming that discretionary spending will grow at the rate of inflation plus population growth, we take a conservative approach here and assume the lower rate of expenditure growth. This results in a higher estimate of the amount of available surplus funds than if we assumed that overall expenditures for discretionary programs would rise at the same rate as GDP.

It is also worth noting that the recently enacted appropriations for fiscal year 2001 — and, therefore, the projections of discretionary spending for future years — include virtually no funding to meet true emergency needs related to natural disasters. Based on emergency spending related to natural disasters in recent years (as opposed to all spending simply

Table 1

CBO's January 2001 Baseline Projections of the Surplus Adjusted to Reflect the Full Costs of Maintaining Current Policies (In trillions of dollars)	Fiscal Years 2002 - 2011
New 2001 Baseline non-Social Security Surplus	$3.1
Exclude Medicare Hospital Insurance (HI) Trust Fund Surplus	-0.4
New Baseline non-Social Security, non-HI Surplus	2.7
Adjustments for more realistic assumptions:	
Discretionary spending grows with population as well as inflation	-0.3
Extend expiring tax credits and reform AMT	-0.2
Continue farm payments at close to current level	-0.1
Debt service	-0.1
Total changes	-0.7
Adjusted January 2001 non-Social Security, non-HI Surplus	2.0

designated as "emergency" spending), such funding could add $100 billion over the next 10 years to any projections that are based on the current appropriations for 2001. To be conservative, we do not consider this amount in our calculation of the size of the available surplus.

B. Maintaining Current Tax and Entitlement Policies. The baseline rules that CBO uses in making surplus and deficit projections generally require CBO to assume there will be no changes in laws governing taxes and entitlement programs. In most cases, maintaining current law means continuing current policies. But in a few cases, this is not true. For instance, about 20 popular tax credits and other tax preferences — such as the research and experimentation tax credit — are typically renewed for only a few years at a time. Most of these credits are scheduled to expire in the next year or two. There is no question the tax credits will be extended, as they command strong bipartisan support and always are renewed. Congress routinely passes a so-called "extender" bill every few years that keeps these popular credits in effect, and it surely will do so again. The CBO projections, however, assume that these tax credits all will expire and the beneficiaries of the credits will thus be subject to tax increases.

Assuming that Congress will allow these tax credits to expire is to assume that a significant change in tax policies will take place; that assumption is not realistic. Employing the more plausible assumption that these credits will be extended through 2011, as almost certainly will occur, reduces projected revenues by about $60 billion over the 2002-2011 period.

Similarly, under current law, the number of taxpayers affected by the alternative minimum tax (AMT) will jump from less than 2 million in 2000 to between 15 million and 17 million in 2010, including nearly half of all taxpayers with two children. To allow this special tax, designed to prevent high-income taxpayers from avoiding income tax through excessive use of tax shelters, to begin affecting millions of middle-income taxpayers not involved in tax shelter activities (as will occur if the law governing the AMT is not modified), would represent a major change in policy. It is extremely unlikely that Congress and the President will allow such a policy change to transpire. Neither party and no political figure would tolerate it. Assuming that the AMT will be reformed to prevent it from hitting rapidly growing numbers of middle-income taxpayers, as virtually all observers expect will be done, reduces projected revenues by about $100 billion over 2002 through 2011.[3]

The baseline rules also lead CBO to assume that billions of dollars in payments to farmers that Congress has provided in each of the last three years will cease being provided. (Since these payments are not governed by ongoing law but are provided one year at a time, the rules lead CBO to assume these payments will terminate.) A halt to these payments, which totaled $26 billion over the last 2½ years and enjoy bipartisan support in Congress, would represent a change in farm policy and is unlikely to occur. It will cost about $100 billion over the next 10 years to maintain something like current policy in this area.

C. Additional Interest Costs. The reductions in revenues and increases in spending that result from using the more realistic assumptions described here would result in less debt reduction than CBO's projections assume. The higher levels of debt would cause federal interest payments to be about $130 billion greater than assumed by CBO over the next 10 years.

When added to the other amounts described here, the total cost of maintaining current policies in these areas thus is approximately $700 billion over 10 years.[4]

Excluding Medicare Surpluses and Funds Needed for Social Security and Medicare Reform

Even the smaller projected surpluses that result when the full costs of maintaining current policies are taken into effect overstate the amounts that will be available to fund tax cuts or initiatives in programs other than Social Security or Medicare.

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[3] This is the cost under current tax law, without the Bush tax cut, of preventing the AMT from affecting growing numbers of middle-class taxpayers. As discussed below, the number of taxpayers affected by, and the revenues collected as a result of, the AMT would increase substantially under the Bush tax plan if the AMT were not reformed.

[4] This $700 billion figure assumes discretionary spending grows at the rate of inflation plus population growth. If, instead, it is assumed that discretionary spending will grow at the same rate as the economy, the reduction in the amount of the non-Social Security surplus that is available is about $1.4 trillion over 10 years, including increased interest costs.

Overwhelming bipartisan majorities in the House and Senate voted last year to prohibit use of the surpluses in the Medicare Hospital Insurance (HI) Trust Fund to finance tax cuts or non-Medicare spending increases. The vote in the House was 420-2. These surpluses should not be assumed to be available to fund tax cuts or spending increases. CBO projects that the Medicare HI surpluses will total $392 billion in 2002 through 2011.

When this $392 billion is added to the approximately $700 billion cost of making more realistic assumptions — which maintain current tax and program policies — a total of about $1.1 trillion of CBO's projected surplus is seen to be unavailable for tax cuts and program expansions. Thus, although CBO projects that the non-Social Security surplus will be $3.1 trillion over the next 10 years under the estimating rules that CBO is required to follows, the amount actually available for tax and program initiatives should be in the vicinity of $2.0 trillion.

As noted earlier, it would not be prudent to use all of this $2.0 trillion for tax cuts and program expansions. One reason is the substantial likelihood that a significant portion of this amount will be needed to help facilitate the enactment of reform packages to ensure the long-term solvency of Social Security and Medicare. Proposals to extend the solvency of the Social Security and Medicare trust funds by relying solely on benefit reductions or payroll tax increases are unlikely to be politically feasible. A transfer of resources from the general fund to these trust funds (or to private accounts) appears to be an essential component of any politically feasible package to ensure long-term solvency for these programs.

The Center estimated last year that if general fund contributions to Social Security and Medicare were to represent only about 30 percent of the resources needed to close the long-term funding shortfalls in these programs — leaving the other 70 percent of the shortfall to be closed through such means as benefit reductions and payroll tax increases — the general fund contribution would amount to about $500 billion over 10 years. The general fund transfer that actually will be needed is likely to be larger. For example, providing contributions equal to two percent of wages into private accounts — which may be a core element of a Social Security proposal that President Bush advances — would cost more than $1 trillion over the next 10 years. Nevertheless, we have continued to use the $500 billion figure as a placeholder in this analysis.

Setting aside a minimum of $500 billion to facilitate long-term Social Security and Medicare reform reduces the amount available to fund tax cuts and program increases to approximately $1.5 trillion over the period from 2002 through 2011. And caution argues for leaving some of this amount uncommitted for now, as a safeguard against the possibility that the projected surpluses may not materialize in full and as a reserve to address urgent needs that may arise in coming years but cannot be foreseen at this time.

II. How Much of the Projected Surpluses Would the Bush Tax Cut Consume?

The Joint Committee on Taxation estimated last year that the tax plan put forward by President Bush during the campaign would reduce revenues by a little more than $1.3 trillion over the 2001-2010 period.[5] Based on that estimate, the full impact of the Bush plan on the budget during the 2002-2011 period would, as explained below, exceed $2 trillion. Furthermore, the impact is likely to be greater than that for two reasons.

First, the Administration reportedly plans to accelerate some provisions of the tax cut that it earlier proposed phasing in over a number of years. If the plan is modified so that its rate cuts alone are accelerated and take effect now — with the other tax cut provisions phasing in as earlier proposed — the plan's cost rises by close to $400 billion over ten years (including the cost of the added interest payments on the debt). This would raise the plan's cost from $2.1 trillion to as much as $2.5 trillion over 10 years.

CBO's new baseline projections will assume higher incomes and higher revenues than CBO and the Joint Committee on Taxation anticipated last year. As a result, the revenue loss stemming from some of the tax cuts proposed during the campaign — particularly the proposed reduction in tax rates — will necessarily be higher than the Joint Committee estimated last year. (If, on average, taxpayers have higher incomes, a given reduction in tax rates will produce larger tax cuts for taxpayers and a greater reduction in federal revenues.) Since no estimate of the revenue losses based on the new projections is available, however, this analysis is based on last year's Joint Committee estimate.

A. Shift in the Budget Window. As explained earlier, the budget window has shifted from the 2001-2010 period used when JCT made its $1.3 trillion estimate. Because another fiscal year has passed, the new baseline window is 2002 through 2011. Since the Bush tax plan has no effect until 2002, dropping 2001 and adding 2011 has a significant effect on the plan's 10-year cost. The JCT estimate showed the cost would be zero in 2001, the year that will be dropped, but $233 billion in 2010. Since the cost of the tax cut will grow after 2010 about the same rate as the economy, the additional cost from adding 2011 is likely to exceed $240 billion. This shift in the budget window increases the 10-year revenue loss from the plan to nearly $1.6 trillion.

B. Assuming Reform of the AMT. The Bush campaign proposal did not specifically call for a general reform of the Alternative Minimum Tax. As a result, JCT's estimate that the Bush tax proposal would cost $1.3 trillion over the 2001-2010 period assumed the AMT would remain

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[5] After issuing this tax plan, the Bush campaign proposed additional tax cuts related to health insurance coverage. No Joint Tax Committee cost estimate is available for these health insurance tax cuts. Based on Joint Tax Committee estimates of the cost of similar proposals offered in Congress in recent years, the cost of these proposals is likely to be in the vicinity of $100 billion over 10 years. The cost of these additional tax cuts is not reflected in this analysis and would need to be added to the figures cited here.

Table 2

Full Cost of the Tax Plan Proposed by President-Elect Bush
(In trillions of dollars)

	10-Year Total
JCT Estimate of Revenue Loss from Bush Plan (2001 - 2010)	$1.3
Adjustments:	
Revenue loss in 2011	0.2
Additional cost of Bush plan if AMT is reformed	0.2
Exclude double-count relating to cost of maintaining current policy included in Center baseline adjustments	-0.1
Subtotal, adjustments to revenue loss	0.4
Adjusted Estimate of Revenue Loss from Bush Plan (2002 - 2011)	1.7
Debt service	0.4
Total Amount of Surplus Consumed by Bush Plan	2.1
Total Amount Consumed if Rate Cuts are Accelerated	2.5

JCT = Congressional Joint Committee on Taxation

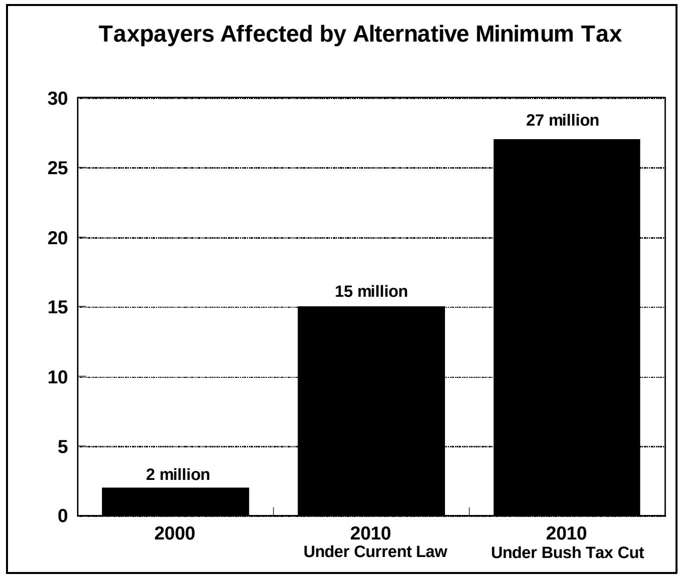
largely unchanged.[6] Yet the JCT has reported that if no changes in the AMT are made, the Bush tax proposals would cause an *additional 12 million taxpayers* to become subject to the AMT. This would be in addition to the large increase in the number of the taxpayers who will become subject to the AMT in coming years under *current* tax laws. Indeed, if the Bush plan took effect and the AMT were not changed, a majority of taxpayers earning $65,000 or more would be subject to the AMT by 2010, compared with only four percent of taxpayers in 2000.

The JCT has estimated that if the AMT is not changed, it would cancel out nearly $200 billion in tax cuts that the Bush tax proposals otherwise would provide. In other words, the $1.3 trillion cost estimate assumes that about $200 billion in tax cuts that the Bush tax plan purports to provide will be negated by an AMT that, if left unchanged, will affect millions of middle-class taxpayers.

[6] The estimate did take into account a limited proposal in the Bush plan to extend the current-law exception to the AMT rules for the child tax credit.

As noted above, it is extremely unlikely that Congress and the President will allow the AMT to affect increasingly large numbers of middle-class taxpayers. Virtually all observers expect the AMT will be reformed to prevent this problem from occurring. Furthermore, the Bush campaign itself evidently did not envision allowing the AMT to cancel out $200 billion of the Bush tax cuts; the estimates the campaign provided the public and the media on the dollar amount of the tax cuts that taxpayers at different income levels would derive from the plan assumed the Bush tax cuts would *not* be canceled out in any way by the AMT.

Figure 2



The JCT has estimated that if the AMT is reformed, the cost of the Bush tax plan would increase by $192 billion over the 2001 through 2010 period.[7]

C. Increase in Interest Costs. The JCT estimate does not include the effect of the proposed tax cut on federal interest payments on the debt. To determine whether projected surpluses are large enough to accommodate a particular tax cut, however, the effect of the tax cut on interest costs must be considered. Reducing revenues substantially, as the Bush proposal would do, would lead to higher levels of debt than if revenues are not reduced and the surpluses that the tax cut consumed are used to pay down debt, as the CBO projections assume.

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[7] Based on an extrapolation of this estimate into 2011, the additional cost of the Bush plan, assuming AMT reform, is about $240 billion in 2002 through 2011. This increase is partially offset by an overlap between the assumption used in this paper that expiring tax provisions will be extended and the cost of certain provisions of the Bush tax plan, such as its extension of the special treatment of the child tax under the AMT and of the research and experimentation credit. Accounting for this overlap reduces the additional cost of the Bush tax plan by about $70 billion, producing a net increase in the cost of the plan of about $170 billion over 10 years when the assumption is made that the AMT will be modified.

Since these costs are related to the increase in the number of taxpayers affected by the AMT as a result of the changes in tax preferences and rates President-elect Bush has proposed, they are in addition to the $100 billion cost of reforming the AMT in the absence of other changes in the tax code, cited in section I above (the section on the amount of surplus that is realistically available for initiatives).

The Bush tax cut would result in additional interest payments on the debt of about $400 billion over 10 years, relative to the CBO surplus projections. The tax plan consequently would reduce surpluses by a total of more than $2.1 trillion over the 2002-2011 period.

The Tax Cut Compared with the Available Surplus

This $2.1 trillion figure exceeds the surplus that is likely to be available under realistic assumptions. Furthermore, this amount does not include additional costs likely to be incurred for accelerating the tax rate cuts in the plan or for other initiatives in areas such as prescription drugs and health insurance, to name a few. A tax cut (or for that matter, program expenditures) of this magnitude also would leave few, if any, resources for three other significant purposes: helping to shore up Social Security and Medicare as part of reform packages that restore long-term solvency to these programs; providing a hedge against the possibility that the expected surpluses will not materialize fully; and leaving a reserve for other important needs that emerge in subsequent years (or that already exist but are not addressed in the next two years).

As a result, the increase in CBO's surplus projections does not signify that a tax cut of this magnitude can be accommodated within the non-Social Security, non-Medicare HI surplus. To the contrary, a realistic look at CBO's surplus projections indicates that if the economic and technical assumptions underlying the budget projections prove accurate, a tax cut of the size the President proposed during the campaign would likely lead to a deficit outside Social Security and Medicare, even without accounting for the cost of the health care and other policies the President advocated during the election campaign.