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CAN THE NEW SURPLUS PROJECTIONS ACCOMMODATE A LARGE TAX CUT?

By Robert Greenstein

In recent weeks, media reports have circulated suggesting that projections of the budget surplus will grow substantially when the Congressional Budget Office releases its new budget forecast later this month or early next month. Some pundits and policymakers have begun issuing pronouncements that this indicates there is plenty of room for a very large tax cut.

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

- What policymakers might expect to be the size of the non-Social Security surplus under the new CBO projections;

- How much of that amount would actually be available for tax cuts and program initiatives; and

- How does the potentially available non-Social Security surplus compare to the size of the tax cut that President-elect Bush proposed in his campaign?

Although there is considerable uncertainty as to what the size of the non-Social Security surplus will be under the new CBO forecast, it is likely to be in the ballpark of $2.5 trillion to $3 trillion over 10 years. (The White House last week issued an estimate of $2.4 trillion.) 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 must follow certain rules that require it to assume that various tax increases and program reductions that neither party favors — and that are very unlikely to take place — will go into effect. Furthermore, the CBO estimate of the non-Social Security surplus includes the temporary surpluses building in the Medicare Hospital Insurance trust fund. 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 — reduces the size of the available surplus by at least $1 trillion. That would leave approximately $1.5 trillion to $2 trillion over the next 10 years.

The sum of $1.5 trillion to $2 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, if legislation to restore long-term Social Security solvency is to be enacted, a transfer of some non-Social Security surplus funds to Social Security (or to individual 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.)

The second reason it would be unwise to consume all of the $1.5 trillion to $2 trillion is that any estimate of the available non-Social Security 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. If the full amount projected is consumed by actions that Congress and the President take in the next year or two but the projections subsequently turn out to have been too optimistic, non-Social Security deficits could return, which might prompt policymakers to cut programs or raise taxes.

A final reason that consuming all of the estimated $1.5 trillion to $2 trillion would be imprudent 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 surplus funds available for subsequent Congresses to use to address needs that cannot be foreseen today but inevitably will arise. It is inconceivable that no such needs will emerge in the eight years following the next two. Such needs could be of a military, international, or domestic nature. While we cannot know today what these needs will be, we can count on some new problems emerging that will have to be faced.

Where the Bush Tax Cut Fits In

This report thus cautions that when realistic assumptions are employed, the available surplus outside Social Security is likely to be in the range of $1.5 trillion to $2 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-elect Bush proposed in the campaign measures up against this standard. That tax cut was the largest budget initiative the President-elect 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-elect Bush said his tax cut would cost $1.3 trillion over 10 years. Many media accounts continue to cite this figure. 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 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 — will cover the 10-year period *from 2002 through 2011*. A simple extrapolation of the Joint Committee on Taxation estimate indicates that this adds more than $240 billion to the cost of the Bush tax cut.

Furthermore, the $1.3 trillion figure was artificially low. In producing it, the Joint Committee had to assume that Congress would allow the Alternative Minimum Tax to encroach heavily upon the middle class over the next decade, subjecting millions of middle-class taxpayers to greatly increased tax complexity and increased tax burdens over what they otherwise would owe. The Joint Committee had to make this assumption because that is the course the AMT will take if no change is made in current law. No knowledgeable observer, however, expects this actually to occur; Congress will not 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 $1.3 trillion estimate the Joint Tax Committee produced assumed that a swollen AMT would cancel out part of the tax reduction the Bush tax cut otherwise would provide.

Finally, in assessing the amount of surplus funds 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 surplus funds 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 be the case, and annual interest payments on the debt would thus be greater. The Bush tax cut would result in additional interest payments on the debt of approximately $400 billion over 10 years.

This brings the total 10-year cost of the Bush tax cut to $2.1 trillion, an amount that appears to exceed the available non-Social Security surplus. 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, would be on top of this.

This analysis now proceeds to examine in more detail the three questions set forth above: What might the new surplus projections show; how much of this surplus is realistically available; and how much of the projected surpluses would the Bush tax cut consume?

I. The CBO Surplus Projections

Last July, CBO projected the non-Social Security surpluses would total $2.2 trillion over the 2001-2010 period if there were no changes in laws governing taxes and entitlement programs and discretionary spending was maintained at the same level as in fiscal year 2000, adjusted for inflation. Any guess about what CBO will report a few weeks from now is speculative, but it seems likely that the projected non-Social Security surpluses for 2002 through 2011 will total somewhere around $2.5 trillion to $3 trillion. (The surpluses in the Clinton Administration's revised baseline budget projections that are scheduled to be released later this month will be somewhat smaller than the likely CBO surpluses. The White House indicated last week that the Office of Management and Budget will project non-Social Security surpluses totaling just over $2.4 trillion over the 2002-2011 period.)

A number of factors will affect how the budget projections that CBO will release later this month or in early February will differ from last July's projections. These include the following:

A. The Effects of Legislation Enacted Since July. Legislation enacted since July, when CBO issued its last projection, will reduce projected surpluses by approximately $500 billion over 10 years.

- Discretionary appropriations enacted for fiscal year 2001 exceed the amount that CBO assumed last July by about $25 billion. Since the new surplus projection will assume that the enacted fiscal year 2001 level, adjusted for inflation, is maintained in 2002 through 2011, projected total discretionary spending will be about $250 billion higher over 10 years than it was in CBO's July forecast.

- Tax legislation enacted since July (primarily the "new markets" tax breaks) will reduce revenues by nearly $50 billion over 10 years.

- Entitlement program legislation enacted since July (primarily new health care benefits for military retirees age 65 and over) will increase spending by close to $100 billion over 10 years.

- These pieces of legislation will reduce the amount by which the federal debt would have shrunk if there had been no changes in policies, and that will cause interest payments on the debt to increase by about $100 billion over 10 years, relative to CBO's July forecast.

The total thus amounts to a reduction of about $500 billion over 10 years in projected surpluses.

B. The Shift in the Budget Window from 2001-2010 to 2002-2011 . Shifting the 10-year budget window used in projecting the surplus from the 2001-2010 period used in CBO's July projection to the 2002-2011 period that will be used in the coming year will increase projected non-Social Security surpluses by about $275 billion over 10 years.

The $102 billion non-Social Security surplus that CBO projected for 2001 in the forecast it issued last July will drop out of the 10-year total and be replaced by a surplus figure for 2011. Based on the trends in the July budget projections, the projected non-Social Security surplus for 2011 would be about $425 billion if CBO were making no changes in assumptions and no legislation had been enacted since July. That would increase the 10-year surplus projection by about $325 billion. However, the legislation described above that has been enacted in recent months will cost about $50 billion more in 2011 than in 2001. Hence, the net effect of shifting the 10-year budget window out one year is to increase the non-Social Security surpluses projected for the next 10 years by about $275 billion.

Table 1

Possible Revisions to CBO's Baseline Projections of the Non-Social Security Surplus (In trillions of dollars)

	10-Year Total
CBO July 2000 Baseline Non-Social Security Surplus (2001 - 2010)[a]	$2.2
Changes due to legislation enacted since July	-.5
Changes due to shifting budget window to 2002-2011	.3
Revised economic and technical assumptions	.5 to 1.0
Total changes	.3 to .8
Possible January 2001 Baseline Non-Social Security Surplus (2002 - 2011)[a]	2.5 to 3.0

[a] Assumes that discretionary appropriations are maintained at the current enacted level, adjusted for inflation.

C. Changes in Assumptions. As always, when CBO prepares its new budget projections it will take into account not only the legislation enacted since it issued its last projections but also any new information about the performance of the economy and trends in revenue collections and program spending. The changes in budget projections that will result from the application of this new information seem likely to increase the non-Social Security surpluses projected for 2002 through 2011 by somewhere in the vicinity of $500 billion to $1 trillion.

According to a number of news reports, CBO has indicated that new information about the sources of economic growth in recent years has caused it to increase its projection of the average growth rate in the economy over the next decade. Although CBO has not revealed the details of this likely change in economic assumptions or the effect the change will have on the budget, the increase in average economic growth apparently under consideration is likely to increase projected non-Social Security surpluses by somewhere in the vicinity of $500 billion to $1 trillion over 10 years, primarily by boosting revenues collected during that period (and by further reducing the debt as a result of these increased revenues, which will reduce the interest paid on the debt).

CBO also will make other changes in its projections of revenues and spending that are not related to newly enacted legislation or changes in economic assumptions. (CBO refers to such changes as "technical" revisions.) For instance, CBO may conclude that unanticipated increases in revenues in the past year are not fully explained by better-than-expected economic performance and, therefore, that projections of future revenues should be boosted by even more than is indicated by the increase in projected economic growth. It also is possible, however, that expenditures for Medicare and Medicaid that in recent months have exceeded CBO’s last projections may prompt CBO to increase the amount of such expenditures it projects over the next 10 years. There will be numerous changes such as these in CBO’s new projections, and it is not possible to know what the net effect of the changes will be until CBO releases the projections. For now, the best assumption is that such changes will largely balance each other out and have little or no effect on the projected surpluses over the next 10 years. This assumption, of course, could prove to be incorrect, which could cause the CBO surplus estimates to be higher or lower than is discussed here.

Taking into account these likely changes in assumptions produces a ballpark estimate that the new CBO estimate of the non-Social Security surplus over the next 10 years will be in the $2.5 trillion to $3 trillion range.

II. The 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 following the "budget baseline" rules laid out in the Balanced Budget and Emergency Deficit Control Act forces CBO to produce surplus projections that understate the true costs of maintaining current policies and consequently overstate the magnitude of the surpluses likely to materialize if policies remain unchanged.[1] 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, if 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 $300 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) despite the presence 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, nondefense discretionary spending grew 20 percent faster than inflation. Reductions in defense

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[1] 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.

Table 2

CBO's Possible 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
Possible January 2001 Baseline non-Social Security Surplus [a]	$2.5 to 3.0
Adjustments for more realistic assumptions:	
Discretionary spending grows with population as well as inflation	-.3
Extend expiring tax credits and reform AMT	-.2
Continue farm payments at close to current level	-.1
Debt service	-.1
Total changes	-.7
Adjusted Possible January 2001 non-Social Security Surplus	1.8 to 2.3
Exclude Medicare Hospital Insurance (HI) Trust Fund Surplus	-.3
Adjusted Possible January 2001 non-Social Security, non-HI Surplus	1.5 to 2.0

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 on this basis. Using this assumption results in an estimate that discretionary spending will be about $300 billion higher for the 2002-2011 period than CBO will project.

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.

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 gross domestic product (GDP). In addition, over the past 14 years, nondefense discretionary spending has grown at essentially the same rate as GDP. Assuming that discretionary spending grows at the same rate as the gross domestic product would add to the forecast an additional $600 billion in discretionary spending over 10 years, over and above the amount projected 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 designated as "emergency" spending), such funding could easily 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 essentially 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 and is not realistic. Employing the more credible 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 approximately 2 million in 2000 to about 15 million by 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.[2]

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 $14 billion in fiscal year 2000 alone 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 over the next 10 years than the CBO projections will assume.

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.[3]

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.

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

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[2] 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.

[3] 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.

be assumed to be available to fund tax cuts or spending increases. The Medicare HI surpluses are likely to total about $300 billion in 2002 through 2011.

When this $300 billion is added to the approximately $700 billion required by use of more realistic assumptions that maintain current tax and program policies, a total of about $1 trillion of CBO's projected surplus is seen to be unavailable for tax cuts and program expansions. Thus, if CBO projects that the non-Social Security surplus will be in the vicinity of $2.5 trillion to $3 trillion over the next 10 years under the estimating rules that CBO is required to follow, the amount actually available for tax and program initiatives should be in the vicinity of $1.5 trillion to $2 trillion.

As noted earlier, it would not be prudent to use all of this $1.5 trillion to $2 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 reform 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. Although 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 reform proposal that President-elect Bush advances — would cost about $1 trillion over the next 10 years), 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 trillion to $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.

III. 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-elect Bush during the campaign would reduce revenues by a little more than $1.3 trillion over the 2001-2010 period.[4] 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. 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 the $1.3 trillion estimate was made to 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 should grow after 2010 at least at the same rate as the economy, the additional cost from adding 2011 is likely to exceed $240 billion. This 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 assumed the AMT would remain largely unchanged.[5] 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 to only four percent today.

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 would be negated by an AMT that affect millions of middle-class taxpayers.

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[4] 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.

[5] 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.

Table 3

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	.2
Additional cost of Bush plan if AMT is reformed	.2
Exclude double-count relating to cost of maintaining current policy included in Center baseline adjustments	-.1
Subtotal, adjustments to revenue loss	.4
Adjusted Estimate of Revenue Loss from Bush Plan (2002 - 2011)	1.7
Debt service	.4
Total Amount of Surplus Consumed by Bush Plan	2.1

JCT = Congressional Joint Committee on Taxation

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 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.

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.[6]

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[6] 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 certain 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.

(continued...)

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 by more than $1.7 trillion over the next 10 years, as the Bush proposal would do, would lead to higher levels of debt than if these funds were used to pay down debt as the CBO projections assume.

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 to 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 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 anticipated 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 likely surplus projections indicates that if the economic and technical assumptions underlying the budget projections prove accurate, a tax cut of the size the President-elect has proposed 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-elect advocated during the election campaign.

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[6] (...continued)

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 cited in section II above (the section on the amount of surplus that is realistically available for initiatives) as the cost of reforming the AMT in the absence of other changes in the tax code.