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SOCIAL SECURITY AND THE TAX CUT: The 75-year Cost of the Tax Cut Is More than Twice As Large as the Long-Term Deficit in Social Security

The full report can be viewed at: http://www.cbpp.org/8-2-01tax.htm

On December 13, the Center on Budget and Policy Priorities released a report, *Social Security and the Tax Cut.* While some policymakers and pundits argue that the tax cut is modest and that Social Security faces an enormous financial chasm, the Center's report shows that the long-term cost of the tax cut (assuming its provisions are extended beyond their scheduled expiration dates) is *more than double* the long-term Social Security shortfall. Because of the tax cut — and because the projections of large and growing surpluses made last spring have turned out to be too optimistic for other reasons as well — resources no longer exist outside of Social Security that could assist in restoring solvency to this program.

When the Center first issued this analysis on August 2, the Administration attempted to refute its findings. The Administration's "refutation" relied, however, upon gimmicks embedded in the tax bill to make the bill's cost appear lower than it actually is. For example, the Administration's estimate of the long-term cost of the tax cut assumed that a provision that protects millions of taxpayers from being subject to the mushrooming individual Alternative Minimum Tax will be allowed to expire after 2004, and as a result, that 35.5 million taxpayers will be subject to the AMT in 2010, compared with 1.4 million today. No credible observer believes Congress (or the Administration) will allow this to happen. (The tax bill effectively sunset this provision after 2004 to help make it appear as though the bill fit within the constraints of the budget resolution; it is widely understood that this or a similar provision will be extended.) In addition, the Administration's estimate of the tax bill's cost did not include the costs of estate tax repeal. The estimate the Administration cited for the size of the Social Security shortfall also was problematic; it differed from — and noticeably exceeded — the estimate of the Social Security shortfall that has been issued by the Social Security actuaries and Trustees. The Administration inflated the actuaries' estimate of the size of the Social Security shortfall by ignoring the assets in the Social Security Trust Fund and effectively assuming that the Trust Fund's $1.1 trillion of Treasury bonds will not be available to finance Social Security benefits.

Even with these distortions, which resulted in an understatement of the cost of the tax cut and an overstatement of the Social Security shortfall, the Administration's "refutation" still conceded that over the next 75 years, the revenue loss from the tax cut will be fully as large as the Social Security shortfall.

The findings of the Center report include:

- According to the official estimates that the Social Security trustees issued in March 2001, the projected long-term deficit in Social Security over the next 75 years — the period used for measuring long-term solvency — equals 0.7 percent of the Gross Domestic Product, or $3.2 trillion in present value. (The present value is the amount today that, with interest, would exactly cover the long-term Social Security deficit.)

- To measure the long-term cost of the tax cut, the Center took the Joint Tax Committee's estimate of the cost of the tax cut in 2011 if all of its provisions are extended and assumed that these costs would remain constant as a share of GDP after 2011. This is the standard approach that the Congressional Budget Office, the Office of Management and Budget, and the General Accounting Office use when preparing long-term fiscal projections.

  The projected cost of the tax cut over 75 years amounts to 1.6 percent of GDP, or $7.7 trillion in present value. Thus, the cost of the tax cut over the next 75 years is more than twice as large as the long-term deficit in Social Security.

- The tax cut is likely to make Social Security reform considerably more difficult, if not impossible, for the foreseeable future. The tax cut consumes non-Social Security resources that are likely to be essential to the development of a politically viable package of reforms to restore Social Security solvency.

  This holds true for plans that include individual accounts as well as plans that do not. Without transfers from the non-Social Security budget, individual accounts would have to be financed from existing Social Security revenue, which would exacerbate Social Security's projected long-term deficit. The Social Security benefit reductions that would be required as part of a plan to shift revenue from the Trust Fund to individual accounts *and* restore long-term solvency to the Social Security system would be so large that they would be likely to doom any such plan. (It may be noted that the plans the President's Social Security Commission approved December 11 include transfers from the non-Social Security budget. The Commission did not explain or offer any recommendations for how such transfers would be financed.)

Policymakers concerned about both the long-term fiscal health of the nation and the restoration of long-term Social Security solvency would do well to examine options for canceling some of the scheduled tax cuts before they take effect (particularly those targeted on households with the highest incomes) and using a portion of the resources as a down-payment in restoring solvency to the Social Security system. Canceling part of the tax cut could, if all goes well, provide the resources for transferring some general revenues to Social Security. Such transfers are likely to be an essential ingredient of a sound Social Security reform package that makes changes in the Social Security program.