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EXTENDING EXPIRING TAX CUTS AND AMT RELIEF WOULD COST $3.3 TRILLION THROUGH 2016

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KEY FINDINGS

- **The tax cuts enacted since 2001 will add more than $1 trillion to the deficit through 2006. Over the next decade, 2007-2016, they will increase deficits by another $2.0 trillion, even if they expire as scheduled.**
- **Making these tax cuts permanent and extending Alternative Minimum Tax relief would cost an additional $2.8 trillion over the next ten years. When the added interest payments that would have to be made are taken into account, the total cost of extending the tax cuts rises to $3.3 trillion over the ten-year period.**
- **All but $0.6 trillion of this $3.3 trillion price tag reflects the cost of extending the tax cuts enacted in 2001 and 2003 (and the portion of AMT relief needed to mitigate the AMT problems those tax cuts have caused).**
- **When the tax cuts enacted in 2001 and 2003 are fully in effect, their annual cost will be more than three times as large as all federal funding for education and also more than three times the cost of all veterans programs.**
- **The cost of these tax cuts will be as large as the entire budgets of the Departments of Education, Veterans Affairs, Homeland Security, Energy, State, HUD, and EPA *combined.***

During President Bush's first term in office, at least one major tax-cut measure was enacted each year. This legislation cut individual income tax rates, repealed the estate tax, and reduced taxes on capital gains and dividends. Between fiscal years 2001 and 2006, these measures will have deprived the Treasury of more than $1 trillion. Despite the country's long-term fiscal challenges, the Administration continues to call for making nearly all of these tax cuts permanent, but has not proposed measures to offset the cost of extending these tax cuts. As a result, the Administration's tax policies would be extremely costly and would contribute significantly to the growth of deficits over the long term.

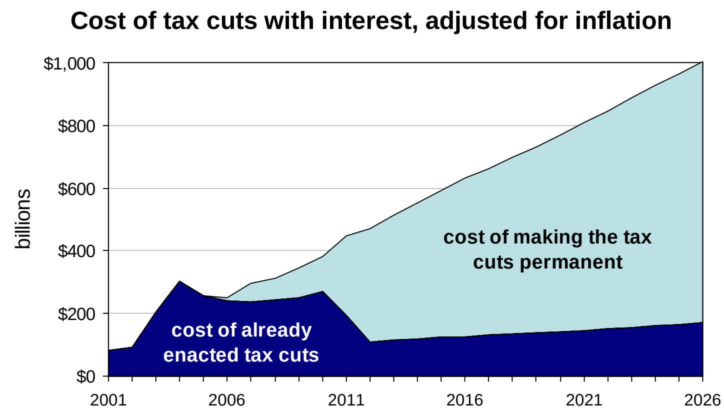
- Making permanent the tax cuts enacted since 2001 would have a direct cost of $2.8 trillion over the next ten years (fiscal years 2007 through 2016), based on Congressional Budget Office estimates. This includes the cost of extending Alternative Minimum Tax relief.[1]
- Without offsets, the cost of making the tax cuts permanent would increase the deficit and thereby add to the national debt. The interest payments needed to service this higher level of debt would amount to $492 billion over the next ten years. Thus, the total cost of making the tax cuts permanent, including the related interest costs, would be $3.3 trillion over the ten-year period. (Most of this cost would come from making the 2001 and 2003 tax cuts permanent; see the appendix at the end of this paper.)

[1] The $2.8 trillion total includes the cost of extending all expiring tax-cut-provisions except those assumed to be one-time tax breaks, such as the dividend repatriation provision and Katrina-related measures. The total includes $914 billion in AMT relief, which reflects CBO's estimate of the cost of adjusting the AMT parameters for inflation and extending the provision of current law that allows non-refundable personal credits to be used to reduce AMT liability.

- In 2016, the cost of the tax cuts alone would be slightly more than $500 billion. This would equal 2.4 percent of the projected size of the economy (i.e., of the Gross Domestic Product) that year.

FIGURE 1

MAKING THE TAX CUTS AND AMT RELIEF PERMANENT WOULD COST TRILLIONS



Source: CBPP calculations from Congressional Budget Office data

These costs would be *in addition to* the high price being paid for the tax cuts already enacted.

- Through fiscal year 2006, the tax cuts enacted since the start of 2001 have had a direct cost of $1.0 trillion. Another $850 billion in direct costs will be incurred before the tax cuts are slated to expire, for a cumulative cost of $1.9 trillion.

- Because these tax cuts have not been paid for, they also are generating substantial increases in the national debt. The additional debt now being built up will persist even if the tax cuts are allowed to expire on schedule. As a consequence, the interest payments that must be made each year on this added debt will continue indefinitely, even if the tax cuts end. (This is the reason that the graph above shows a cost of more than $100 billion a year from the tax cuts in years after 2010, even if the tax cuts are permitted to expire.) The increased interest costs caused by the tax cuts already enacted will total $1.3 trillion from 2001 through 2016.

- Thus, the overall cost of the tax cuts enacted to date, including the related interest costs, will total $3.2 trillion through 2016.

- Since the cost of the tax cuts already enacted will be $3.2 trillion through 2016, and the cost of making the tax cuts permanent will be another $3.3 trillion over the same period, the combined cost will be $6.5 trillion through 2016, if the tax cuts are extended. Of this total, $5.4 trillion will occur in the coming ten-year period — the period from 2007 to 2016. (See Table 1.)

The costs of making the tax cuts permanent would reach even higher levels in subsequent decades. In the decade following the current ten-year budget window — the period from 2017 through 2026, when all of the tax cuts would be in effect for the full ten years — the cost of making the tax cuts permanent would be $6.3 trillion before taking interest costs into account, and $9.9 trillion with the interest costs.[2] It is during this period that deficits will reach or approach unsustainable levels, as the number of baby boomers who have reached retirement age mounts and

[2] These estimates are expressed in "current" dollars. If they were expressed in constant 2005 dollars, the cost of extending the tax cuts would be $2.4 trillion for the first ten-year period through 2016, and $4.3 trillion for the second ten-year period, 2017 through 2026. With interest costs included, the totals would be $2.8 trillion in the first decade and $6.8 trillion in the second decade.

Table 1 COST OF TAX CUTS AS ENACTED AND OF MAKING THE TAX CUTS PERMANENT, THROUGH 2016* (In Trillions of Dollars)	
Cost of Tax Cuts as Enacted	
Enacted Tax Cuts *Without* Interest Costs	
Cost 2001 through 2006	$1.0
Cost 2007 through 2016	0.9
Cost, 2001 through 2016	**1.9**
Enacted Tax Cuts *With* Interest Costs	
Cost 2001 through 2006	$1.1
Cost 2007 through 2016	2.0
Total cost, 2001 through 2016	**3.2**
Cost of Extending Tax Cuts**	
Cost 2007 through 2016	$2.8
Interest costs	0.5
Total cost, 2007 through 2016	**3.3**
Cost of Enacted and Extended Tax Cuts	
Cost 2001 through 2016	$4.7
Interest costs	1.8
Total cost, 2001 through 2016	**6.5**

*Figures are based on Joint Committee on Taxation and Congressional Budget Office estimates of the cost of tax-cut provisions through 2016, and CBPP calculations. Interest costs are calculated using CBO's standard methodology and assumptions. Details may not add to totals due to rounding.

** Includes the extension of all tax cuts enacted since the start of 2001, except for those which are explicitly temporary (such as bonus depreciation, repatriation, and Katrina-related relief). The estimates also include the cost of continuing the so-called "extenders," a group of "temporary" tax breaks (such as the research and experimentation credit) that pre-dated the Bush administration but whose extension the Administration supports.

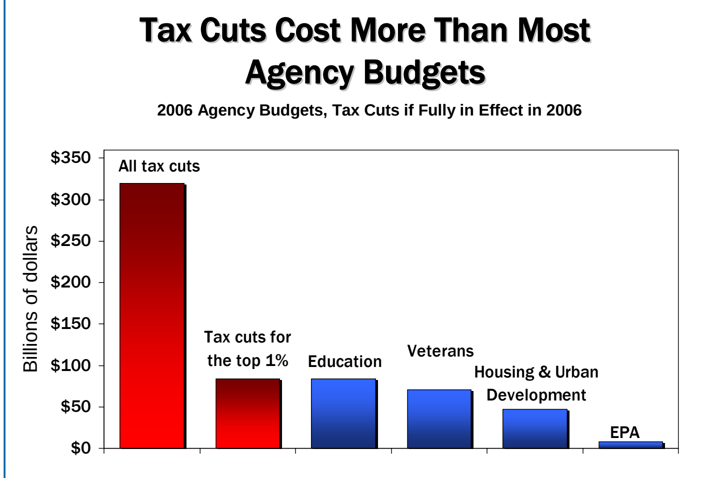
health care and pension costs for these individuals grow. Making the tax cuts permanent would substantially exacerbate this already-difficult problem.

The multi-trillion dollar figures cited here are difficult for many people to comprehend. Accordingly, we provide two comparisons below to help put the costs of the tax cuts in some perspective. The first of these comparisons relates the annual cost of the tax cuts to the budgets of various federal agencies, such as the Departments of Education and Veterans Affairs. The second comparison looks at how the cost of the tax cuts, if made permanent, will compare to the size of the Social Security shortfall.

Tax Cuts Cost More than Most Federal Agencies

A number of the tax cuts affecting high-income households have not yet taken full effect. Repeal of the estate tax, for instance, does not take effect until 2010. In addition, two tax cuts enacted in 2001 eliminate current-law provisions that reduce the value of itemized deductions and personal exemptions for high-income taxpayers; these tax cuts did not start to phase in until January 1, 2006, and will not take full effect until 2010. Figure 2 compares the annual cost of the tax cuts when they all are fully in effect to the budgets of various federal agencies. As the figure indicates, when the tax cuts are fully in effect:

FIGURE 2



Source: CBPP calculations from CBO and OMB data

- Their cost will be more than three times as large as all federal funding for education at elementary, secondary, and post-secondary levels combined. It also will be more than three times the cost of all veterans programs, including veterans health care, veterans pensions, veterans disability compensation, and other veterans services.

- The cost of the tax cuts will dwarf the budgets of smaller departments. The cost of the tax cuts will be 30 times the Environment Protection Agency's budget and more than five times the cost of all housing and urban and community development programs operated by the Department of Housing and Urban Development (i.e., more than five times the full HUD budget).

- Looked at another way, the cost of the tax cuts will equal the cost of all of these agency budgets *combined*: education, veterans affairs, homeland security, state, HUD, EPA, and energy.

- Just the cost of the tax cut for the *top one percent* of households, a group whose average income is about $1 million a year, will be nearly the same as the total amount the federal government spends on education at all levels. The cost of the tax cut for the top one percent also will be about as large as the cost of everything the federal government spends for veterans.

Tax Cuts Cost Three Times More than Social Security Shortfall

Throughout last year's debate on Social Security, the White House emphasized the magnitude of the shortfall in the Social Security Trust Fund, as part of its efforts to build support for its proposal to replace part of Social Security with private accounts. The size of the Social Security shortfall pales, however, in comparison with the cost of making the tax cuts permanent.

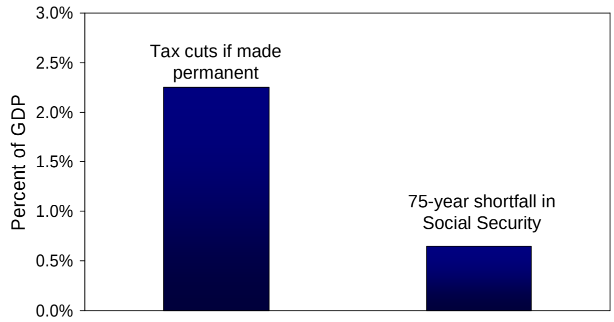
- The Social Security actuaries project that over the next 75 years — the period customarily used to assess Social Security's finances — the deficit in the Social Security trust fund will equal 0.7 percent of GDP.

- In contrast, Joint Tax Committee estimates indicate that the cost of making the tax cuts permanent equals about 2 percent of GDP over the next 75 years.[3]

- Thus, the cost of making the tax cuts permanent will be *three times larger* than the size of the Social Security shortfall over the next 75 years.[4]

FIGURE 3

THE TAX CUTS AND SOCIAL SECURITY:
Costs through the next 75 years



Source: Social Security Trustees Report estimate of Social Security shortfall, CBPP calculation of tax cut costs based on Joint Committee on Taxation estimates

- In fact, just the cost of the tax cuts for the top one percent of households, which equals about 0.5 percent of GDP, is nearly as large as the entire Social Security deficit, if the Social Security actuaries' estimate of that deficit is used.[5]

The Tax Cuts and the Economy

In recent statements, President Bush and members of his Administration have argued that the tax cuts have contributed to a robust economic expansion and need to be made permanent for the sake of the economy. A leading White House official declared, "we don't want a temporary expansion, so we shouldn't have a temporary tax cut, we should make it permanent."[6] The President echoed this remark in his State of the Union address.

The reality, however, is that every recession in modern U.S. history has been followed by an economic expansion, regardless of whether taxes were cut, raised (as in the early 1990s), or left unchanged. The recent tax cuts are *not* responsible for the current recovery, just as the tax *increases*

[3] The cost of the tax cuts, when fully in effect, equals approximately two percent of GDP. CBO, OMB, the GAO, and other estimators customarily project that once tax cuts reach a steady state, their costs remain constant over time as a share of GDP.

[4] The cost of the tax cut still exceeds the size of the Social Security shortfall even if projections extend beyond the 75-year time frame to an "infinite horizon," a time-frame that some experts question but that the Administration frequently uses in discussing Social Security's financing challenges.

[5] The cost of the tax cuts for the top one percent of households will be *larger* than the Social Security shortfall if the Congressional Budget Office's estimate of the Social Security shortfall (rather than the Social Security actuaries' estimate) is used.

[6] Transcript of Press Briefing by Dan Bartlett, Counselor to the President, on the State of the Union Address, January 31, 2006.

of 1990 and 1993 were not the reason the economy recovered from the downturn of the early 1990s instead of remaining permanently stagnant.

Moreover, despite the tax cuts, the current recovery is not an exceptional or even an average one. If tax cuts are crucial to economic growth, then with at least one major tax cut a year for four straight years, the current recovery should stand out brightly in comparison to previous recoveries. It certainly should outshine the comparable years of the recovery of the 1990s, which followed two significant tax increases. Instead, economic growth has been weaker during the current recovery than during the average post-World War II recovery and about the same as in the comparable years of the 1990s recovery. Moreover, investment growth has been notably weaker in the current recovery than in both the average recovery and the 1990s recovery, despite the enactment of major tax cuts since 2001 that were directly targeted at investment. Finally, employment and wage and salary growth have been especially weak; employment growth during this recovery has been slower than during *any* prior post-World War II recovery.[7]

Of particular concern, making the tax cuts permanent would be as or more likely to *reduce* long-term economic growth as to increase it, because of the tax cuts' effects in swelling deficits and debt. A number of studies from highly respected institutions and economists have found that, if major tax cuts are deficit-financed, the negative effects of higher long-term deficits will cancel out or outweigh any positive economic effects that otherwise might result from the tax cuts.[8] All else being equal, deficits lower national saving and thereby lower future national income. For instance, a comprehensive study of the tax cuts by Brookings Institution economists William Gale and Peter Orszag found that making the tax cuts permanent without offsetting their cost would be "likely to reduce, not increase, national income in the long term."[9] The bottom line is that large deficit-financed tax cuts are as or more likely to reduce investment and economic growth as to increase them.

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[7] For more detailed comparisons between this and other recoveries, see Isaac Shapiro, Richard Kogan, and Aviva Aron-Dine, "How Does This Recovery Measure Up?" Center on Budget and Policy Priorities, revised January 9, 2006, http://www.cbpp.org/8-9-05bud.pdf.

[8] See, for example, Mark M. Zandi, "Assessing President Bush's Fiscal Policies," Economy.com, July 2004; Alan J. Auerbach, "The Bush Tax Cut and National Saving," *National Tax Journal*, Volume LV, No. 3, September 2003; and Douglas W. Elmendorf and David L. Reifschneider, "Short-Run Effects of Fiscal Policy with Forward-Looking Financial Markets," prepared for the National Tax Association's 2002 Spring Symposium.

[9] Williams Gale and Peter Orszag, "Bush Administration Tax Policy: Effects on Long-Term Growth," *Tax Notes*, October 18, 2004. Also see Gale and Orszag, "Deficits, Interest Rates, and the User Cost of Capital: A Reconsideration of the Effects of Tax Policy on Investment," Urban Institute-Brookings Institution Tax Policy Center, August 19, 2005, where they find that if tax cuts are deficit-financed, the higher interest rates that result are likely to weaken investment sufficiently to outweigh any positive economic effects the tax cuts may otherwise have.

Appendix

2001 and 2003 Tax Cuts Represent Vast Majority of the Cost of Extending Expiring Tax Cuts

The tax cuts enacted in 2001 and 2003 — which include reductions in the top income tax rates, expansion of the child tax credit, repeal of the estate tax, creation of a 10 percent bracket, reduction in capital gains and dividend tax rates, and other provisions — are extremely costly:

- Between fiscal years 2001 and 2006, these tax cuts will cost nearly $1 trillion, not counting interest costs, and $1.1 trillion when the interest costs are included.

- These tax cuts will cost another $0.8 trillion in lost revenue between 2007 and 2016, even though they are scheduled to expire by 2010. They also will result in $1.1 trillion in additional interest payments between 2007 and 2016, even if they expire on schedule. This raises the total impact of the tax cuts on the deficit to $1.9 trillion over the 2007-2016 period, if they expire as scheduled. (The interest costs are very high because the increases in the debt that the tax cuts are generating will endure even if the tax cuts expire.)

- Thus, even if allowed to expire, these tax cuts will increase the debt by a total of $3 trillion by 2016.

Extending the tax cuts, rather than allowing them to expire, will cost *another $2.7 trillion* between 2007 and 2016. These costs consist of the following:

- $1.7 trillion to extend the tax-cut provisions enacted in 2001 and 2003.

- $671 billion to extend the associated Alternative Minimum Tax relief. The 2001 and 2003 tax cuts worsened the AMT problem that existed prior to 2001. (An additional $243 billion of AMT relief would be needed to address the AMT problem that existed prior to 2001.)

- $387 billion for the higher interest payments on the debt.

In addition to the 2001 and 2003 tax cuts and AMT relief, a number of other tax cuts are slated to expire over the next few years. Most of these tax cuts pre-dated the Bush Administration and often are referred to as “extenders,” because they have been routinely extended many times with bi-partisan support. Extending these provisions would cost $267 billion (or $324 billion with interest) between 2007 and 2016.

Combining all of these costs — $2.7 trillion for extending the 2001 and 2003 tax cuts and related AMT relief, $0.3 trillion for extending the provisions known as the “extenders,” and $0.3 trillion for relief to address the AMT problems that existed prior to 2001 — yields a total cost of $3.3 trillion between 2007 and 2016 for extending all expiring provisions (except those that clearly will be allowed to expire, such as the Katrina-related tax reductions).