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HOUSE TO CONSIDER MORE TAX CUTS

Even Though Tax Cuts It Has Already Passed Exceed Budget Resolution Targets

by Joel Friedman and Andrew Lee

Despite recent projections by the Congressional Budget Office that show a sharp deterioration in the budget outlook, the House of Representatives is scheduled to consider another tax cut on Thursday, September 12. This proposal offers a tax break for a range of expenses related to elementary and secondary education, and carries a ten-year price tag of $4.9 billion, according to the Joint Committee on Taxation. This cost estimate is deceptively low, however, because the proposed tax cut is structured so that it expires at the end of 2005. If the proposal were extended rather than be allowed to expire — as is the case for most other temporary tax breaks in the tax code and would likely be the case here — it would cost about $19 billion over the decade from 2003 through 2012.

In addition to making the proposal temporary to mask its true long-term cost, the House Leadership has argued that the tax cut is affordable because it fits within the $28 billion allocation for tax cuts between 2003 and 2007 that was included in the House budget resolution.

- Yet the House has already passed tax cuts totaling $47 billion between 2003 and 2007.
- When looked at over ten years, from 2003 through 2012, these House-passed bills lose *$452 billion* of revenue. Much of this cost reflects the impact of making permanent the provisions in last year's tax-cut package that expire at the end of 2010, outside the period covered by the House's five-year budget resolution.
- In addition, House Budget Committee Chairman Jim Nussle has said that the $28 billion allocation also would be available for new tax cuts that President Bush suggested after the economic summit in Waco, Texas.

Although the House Leadership portrays its $28 billion budget resolution allocation as a meaningful constraint on tax-cut proposals, the allocation appears to impose few or no limits on the House's tax-cutting plans. Further, the House budget resolution itself is suspect because it relies on the Administration's rosy economic and other estimating assumptions from February. If the resolution were updated to reflect the new CBO assumptions, the resolution would be in deficit in every year even without the $28 billion in tax cuts. Given this worsening of the budget outlook — in both the near term and long term — it is hard to argue that more deficit-increasing tax cuts are advisable.

House-Passed Tax Bills Exceed Budget Resolution Targets (dollars in billions)	Five years 2003-2007	Ten years 2003-2012
Revenue reductions permitted under House-passed budget resolution	$27.9	no limit
Enacted tax cuts to date	3.6	5.4
Remaining room for tax cuts	24.2	no limit
House-passed tax cuts (not enacted):		
Passed in 2001*		
Energy bill	21.1	33.4
Patients bill of rights	6.3	21.9
Charitable giving	4.5	13.3
Bankruptcy reform	0.2	0.5
Terrorism insurance	-1.4	-5.3
Passed so far in 2002		
Make tax cut permanent	9.0	373.7
Access to long-term care	1.4	5.3
Pension security**	0.9	2.4
Accelerate marriage penalty relief	0.9	0.9
Other	0.1	0.3
TOTAL, House-passed (not enacted)	43.0	446.4
House-passed tax cuts in excess of remaining room under resolution	18.8	

* The estimated costs of tax cuts passed in 2001 are shifted one year, to reflect an assumption of a one-year delay in the effective date of the measures.

**The House-passed pension bill includes a provision that would prevent certain stock options from being subject to payroll taxes. At the time it passed the House, the Joint Tax Committee estimated that the provision would cost $23.2 billion over ten years. A subsequent Treasury regulation, however, implemented the House position. As a result, the Joint Tax Committee now estimates that the provision would have only a "negligible revenue effect." The figures in the table reflect these revised estimates.

Source: Joint Committee on Taxation; Congressional Budget Office.

Worsening Budget Outlook

The House continues to propose more tax cuts that increase the deficit, despite the worsening of the budget outlook. In January 2001, the Congressional Budget Office projected a surplus of $5.6 trillion from 2002 to 2011. In the latest CBO forecast, the ten-year surplus has declined by $5.3 trillion, or 94 percent, to $336 billion. Furthermore, most of this projected surplus is based on the unrealistic assumption that last year's tax cut will completely expire at the end of 2010.

Revenue losses are the overwhelming factor behind the disappearance of the actual and projected surpluses. Revenue losses — from last year's tax cut, from the "stimulus" bill, and from economic and technical reestimates — account for 82 percent of the $5.3 trillion deterioration in the surplus. Increased costs of defense, homeland security, and international programs account for 16 percent of the deterioration. Domestic spending increases outside of homeland security account for two percent of the deterioration.[1]

Finally, even the projected $336 billion surplus is likely to prove illusory as it is based on current law baselines and omits a number of virtually inevitable costs. Additional costs likely to be incurred — including extending the tax cut, Alternative Minimum Tax relief, the President's defense and homeland security increases, and a prescription drug benefit — amount to approximately $1.5 trillion to $2 trillion over ten years.

House Budget Resolution

The House-passed budget resolution (H.Con.Res. 353) covers the years 2003 through 2007 and allows a reduction in revenues totaling $27.9 billion over those years. The House Budget Committee maintains that, even with these tax cuts, the resolution represents a fiscally responsible plan. Yet by limiting the resolution to cover only five years, it fails to place *any* constraint on tax cuts after 2007, thereby opening the door to the high costs entailed in making last year's tax cut permanent. Moreover, to achieve its budget goals within the limited five-year horizon, the resolution relies on a number of gimmicks, from including unspecified reductions in domestic appropriations to substituting the more optimistic economic and technical assumptions of the Office of Management and Budget for the CBO assumptions that are traditionally used in congressional budgets.[2]

If the budget resolution is reestimated, using the current CBO projections, a far different picture emerges. Compared with the February OMB assumptions used in the resolution, the new CBO assumptions show a $667 billion deterioration in the budget between 2003 and 2007, the five-year period covered by the budget resolution. Over ten years, 2003 through 2012, the deterioration is $1.2 trillion larger under the latest CBO assumptions than under the old OMB assumptions on which the House budget resolution is based. Using the updated CBO estimates, the House Budget Resolution would be in deficit every year from 2003 through 2007, rather than in balance or in surplus as originally claimed by the House Budget Committee. The budget would still be in deficit in each year even without the $28 billion in tax cuts.

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[1] All figures in this paragraph include both the direct reason the surplus shrank and the resulting increase in interest payments generated by lower surpluses and higher debt than initially projected. For more details on the current budget outlook, see Richard Kogan and Robert Greenstein, "The New Congressional Budget Office Forecast and the Remarkable Deterioration of the Budget Surplus" and "An Examination of Recent Budget and Economic Projections by the Congressional Budget Office," Center on Budget and Policy Priorities, September 3, 2002.

[2] See Richard Kogan and Robert Greenstein, "Analysis of the House Budget Plan," Center on Budget and Policy Priorities, March 25, 2002.

The Proposed House Education Tax Breaks

The House is scheduled to consider a proposal that would allow a married couple with income below $40,000 (or below $20,000 for a single individual) to deduct up to $3,000 of elementary and secondary education expenses. A similar deduction for higher education expenses was included in the tax-cut package that was enacted last year. The proposal would expire at the end of calendar year 2005 and would cost $4.9 billion over the next ten years, according to the Joint Committee on Taxation. If the deduction were made permanent, however, it would cost approximately $19 billion over the decade — or nearly four times the advertised cost. (This ten-year estimate assumes that the measure's $1.7 billion cost in fiscal 2005, the last year when it is fully in effect, remains a constant share of the economy throughout the decade.)

The proposed deduction would be "above the line" — meaning that it would be available even to those tax filers who do not itemize their deductions. It is, however, not refundable. Thus it would offer no assistance to those tax filers whose incomes are low enough that they owe no income tax. In 2003, a married couple with two children owes no income tax until their income reaches $20,150, reflecting the impact of the standard deduction and personal exemptions. If the family has more than two children or is currently making use of other deductions and non-refundable credits, such as the dependent care tax credit, the income level at which the proposed deduction would yield tax savings is even higher.

Beyond its cost and lack of availability to low-income families, the proposal is problematic because it includes such a broad definition of eligible education expenses, making it very difficult for the Internal Revenue Service to ensure compliance. In addition to tuition and school fees, eligible expenses include the cost of books, supplies, uniforms, transportation, extended day programs, computer equipment, and internet access. With this wide-range of items, it would be nearly impossible for the IRS to enforce compliance.

Given this sharp change in the budget outlook, the original claims about the affordability of the additional tax cuts called for in the budget resolution are even more dubious than when they were first made.

House-Passed Tax Cuts

The House budget resolution does not specify which revenues should be reduced to meet its $28 billion target. The Budget Committee report notes that the specific tax policies would be determined by the Ways and Means Committee, but could include a range of proposals, such as "incentives for charitable giving, education tax breaks for teachers and for families transferring their children out of failing schools, and energy conservation, reliability, and production provisions."

The tax proposals mentioned in the Budget Committee report reflect tax breaks in the President's 2003 budget. The House had already passed many of them in 2001, prior to adopting the budget resolution, as part of an energy bill and a measure providing tax incentives for charitable giving. Together these two bills would reduce revenues by $26 billion over five years — or more than 90 percent of the budget resolution allocation.[3] In addition, the House passed other measures in 2001 — such as the Patients Bill of Rights and bankruptcy reform — that would lose revenues. When these measures are taken in account, the five-year total grows to over $30 billion. Stated another way, the House had already passed enough tax cuts to exceed the entire allocation provided in the budget resolution *before* the resolution was even adopted.[4]

Once the budget resolution was adopted in March 2002, however, the House continued to pass tax cuts, including a measure to make permanent all of the provisions in last year's tax-cut package that expire in 2010.[5] This proposal would reduce revenues by $9 billion over the five years covered by the budget resolution — but by $374 billion over the ten-year period through 2012, and by $4 trillion in the decade thereafter. The cost in the first five years primarily reflects the impact of making estate tax repeal permanent, which would cause some wealthy families to change their behavior and sell fewer assets (and thus realize lower capital gains) during their lifetimes.

To date, the House has passed measures that reduce revenues by $46.7 billion between 2003 and 2007. Four of these bills, totaling $3.6 billion, have been enacted into law, leaving $24.2 billion of the budget resolution's $27.9 billion allocation available. But the remaining measures that the House has passed to date would, if enacted, lose $18.8 billion more than remains available under the allocation. If the House were also to pass the education tax cut scheduled for a vote this week, the amount by which House-passed tax cuts would exceed the House's own budget would rise to $23.7 billion.

Some have argued that these various House-passed measures are being bottled up in the Senate and there is little chance of these bills becoming law, thereby freeing the House to continue to pass more tax cuts. This viewpoint is flawed for at least two reasons. First, it is not clear what will become of these bills, particularly given that many have bipartisan support. In the closing days of a session of Congress, particularly when there is the added pressure of a closely contested election, legislative surprises are far from uncommon, with apparently moribund bills suddenly coming to life and being enacted into law.

Second, continuing to pass more and more tax cuts undermines the setting of priorities that is implicitly required by the establishment of a budget resolution target. If the House wants to stay within its budget resolution target, not all of the tax cuts it has passed can become law. House Budget Committee Chairman Jim Nussle has acknowledged that, to meet the resolution's

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[3] For the provisions passed in 2001, the Joint Tax Committee cost estimates covered the period 2002 to 2011. For this analysis, we assumed that, if the provisions are enacted in 2002, the costs will be shifted out one year (covering 2003 to 2012), consistent with a one-year delay in the effective date.

[4] Although passed prior to the budget resolution, these measures are relevant for the resolution's tax cut allocation; if enacted, they would count against the allocation.

[5] The House has not only passed a measure that would extend permanently all of the provisions in last year's tax-cut package that expire in 2010, but has also passed separate bills that would extend many of the individual provisions in the package.

targets, "[t]here are tax bills that have passed that may have to be reeled in."[6] The House Leadership, however, has taken no action to "reel in" any of these tax bills or establish priorities among them.

Conclusion

The House continues to consider more tax cuts — such as the education tax breaks scheduled for this week — and defends them as affordable under the terms of the House-passed budget resolution. The resolution provided for $28 billion of new tax cuts between 2003 and 2007. But the House has so far passed $47 billion of tax cuts over this five-year period, well beyond the resolution's target. Further, the real costs of these proposals explode outside the period covered by the budget resolution. When looked at over ten years, these same provisions would cost nearly ten times as much, or $452 billion, calling into question the effectiveness of the House budget resolution as a tool to restrain fiscally irresponsible policies.

Moreover, the resolution itself is based on optimistic and now out-dated assumptions. If the resolution were reestimated using the new CBO assumptions, the resolution would be in deficit in each of the five years it covers. Given this deterioration in the budget outlook, House action to pass further tax cuts would be ill-advised.

[6] Bud Newman, "CBO Projects Deficits Through FY 2005, Then Surpluses if Tax Cuts Not Extended," *Bureau of National Affairs Daily Tax Report*, August 28, 2002.