The Bush Tax Cut: The Morning After

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On June 7, 2001, George W. Bush signed into law a tax cut that had been a defining feature of his presidential campaign. Although the new law is not a photocopy of his original plan, it is sufficiently close to allow the President to claim victory and put his stamp on the largest tax cut since 1981.

Yet, the manner in which victory was achieved raised as many questions as it resolved. This, after all, was a tax cut bill submitted even before the President submitted a budget to go along with it. The resulting unresolved tension apparently led Vermont's Senator James Jeffords to leave the Republican Party, changing the balance of power in the Congress. And it is already clear that the tax cut, combined with even a minimal number of other initiatives favored by both parties, will put extreme pressure on the federal budget.

At an operational level, many of the tax changes are just plain odd. Different provisions phase-in and phase-out in different years in a seemingly random fashion, and the entire tax cut disappears—"sunsets"—after 2010. These features make tax planning difficult and create uncertainty about the evolution of tax policy, all of which will undermine the positive incentive effects associated with the cut in marginal tax rates.

Equally problematic, the magnitude and structure of the tax cut were never well-justified, relative to other policy goals, and many of the Administration's claims about its plan were misleading at best. Even those who supported the tax cut wholeheartedly may well feel dismayed at the manner in which it was lobbied and passed.

A First Look

The most novel aspect of the new law is the "sunset" provision kicking in at the end of 2010. Come Jan. 1, 2011, the tax code reverts to what it would have been had the bill never passed. The only underlying rationale: finessing budget procedures that would have made it impossible to reconcile the tax cut with the last Congressional budget resolution. Before the sunset, the tax law will, among other things (see Table 1):

Reduce the highest marginal income tax rates. The 28, 31, and 36 percent tax rates (which apply to married households with taxable income above $45,200, $109,250, and $166,500, respectively) will each fall by 3 percentage points, and the 39.6 percent top rate (which applies to married households with taxable income above $297,350) will fall to 35

percent. Each of these rates declines by 1 percentage point as of July 1, 2001, a second point in 2004, and the reductions are completed in 2006.

Eliminate the estate tax. The effective exemption in the estate tax is raised from $675,000 currently to $1 million in 2002, and then gradually to $3.5 million in 2009. The top effective marginal tax rate is reduced from 60 percent to 50 percent in 2002 and then gradually to 45 percent in 2009. The federal credit for state estate taxes is gradually phased out between 2002 and 2005, after which it is replaced by a deduction. (This shift, incidentally, finances about one-quarter of the cost of the estate tax cut.) In 2010, the estate and generation-skipping transfer taxes are repealed, the highest gift tax rate is set equal to the top individual income tax rate, and the step-up in basis for inherited assets that have capital gains is repealed.

Create a new 10 percent income tax bracket. A new 10 percent bracket is carved out of the first $6,000 of taxable income for singles, the first $12,000 for married couples. This income is currently taxed at a 15 percent rate.

Increase and expand eligibility for the child credit. The child credit is gradually increased, from $500 to $1,000 by 2010. It is also made refundable to the extent of 10 percent of a taxpayer's earned income above $10,000 for 2001-4 and 15 percent for subsequent years, with the $10,000 figure indexed for inflation. Refundability benefits low-earnings households with little or no income tax liability, but who do pay other federal taxes.

Partially address the marriage penalty. The standard deduction for married couples gradually rises from 174 percent to 200 percent of the standard deduction for singles in the years 2005 to 2009. The top income level in the 15 percent bracket for married couples gradually rises from 180 percent to 200 percent of the similar level for singles from 2005 to 2008.

Liberalize pension and IRA incentives. The major changes include an increase in the contribution limits for Individual Retirement Accounts and Roth IRAs to $5,000 by 2008 and a gradual rise in contribution limits to 401(k) and related plans to $15,000 in 2006. Additional "catch-up" contributions of up to $5,000 for anyone over the age of 50 will be permitted, while a non-refundable credit for retirement saving for low-income taxpayers will be available between 2002 and 2006.

Liberalize education incentives. Taxpayers may take an above-the-line deduction for qualified higher education expenses, but only between 2002 and 2005. Effective in 2002, the contribution limit on education IRAs rises to $2,000 from $500. Pre-paid tuition programs will now benefit from tax-free withdrawals as long as the funds are used for education, while deductions for student loans are made more generous.

Provide limited Alternative Minimum Tax relief. Between 2001 and 2004, the AMT exemption is increased by $2,000 for single taxpayers and $4,000 for married taxpayers – and then reverts to current law.

The reduction in tax revenue is estimated at $1,275 billion over 10 years according to Congress' Joint Committee on Taxation. But since the bill also provides cuts in 2001, the total

reduction in revenue is about $1,349 billion (see Table 2). The effect of the tax cut on the surplus is determined not just by the tax cut, but also by the added federal interest payments required because federal debt is higher than it otherwise would be. That puts the cost at $1,677 billion through 2011, if the sunset holds. If all the phased-out provisions were extended, the cost would exceed $2 trillion.

Tax Cuts and the Budget

The central justification for a large tax cut came from the view that the government was running a large surplus. But this is putting the cart before the horse. Yes, the Congressional Budget Office in January estimated a baseline surplus of $5.6 trillion between 2002 and 2011. But that figure is a very poor guide to policy choices, for several reasons. First, the baseline uses cash flow accounting, which includes trust fund accumulations for Social Security, Medicare and government pensions, but ignores their accruing liabilities – the money owed to future retirees. Second, the spending and tax revenue projections are unrealistic. Third, the baseline ignores the uncertainty of fiscal projections. Fourth, the 10-year horizon is terribly misleading with respect to the future of Medicare and Social Security and the fiscal status of the government. The surplus can be adjusted, however, to account for most of these issues.

<u>Adjusting the 10-year baseline</u>

Much of the projected 10-year budget surpluses is driven by Social Security's $2.5 trillion surplus over the next decade. In the 1990s Washington agreed that accruing Social Security trust fund balances should not be used to finance tax cuts or other spending programs – if for no other reason than the reality that unrecorded liabilities far outstrip the cash flow.

Medicare pays for health care for the elderly. Part A, which covers hospital insurance and is financed by payroll taxes, is similar in structure to Social Security. Over the next 10 years, the Medicare trust fund that covers Part A is projected to run surpluses totaling $392 billion. Although Medicare is officially part of the on-budget surplus, Congress has voted repeatedly to protect the trust fund from other uses.

Pension reserves for federal military and civilian employees are projected to accrue surpluses of $419 billion over the next 10 years. Under current law, these surpluses remain on-budget. Like Social Security and Medicare, however, the money represents accumulations intended to provide future retirement benefits. Thus, the same economic logic that has led fiscally responsible leaders to protect Social Security and Medicare balances implies that government pension reserves should be protected as well.

The CBO's baseline only measures the implications of maintaining "current policy," which is subject to a variety of statutory requirements. Thus, one should not confuse the CBO baseline with a forecast of what is likely. Discretionary spending poses thorny problems here. Unlike mandatory spending, funds for defense, education, the environment, and the like are not automatically included in the annual budget and thus require annual appropriation. CBO simply assumes that real discretionary spending will remain constant at fiscal year 2001 levels.

That's probably unreasonable. Discretionary spending totaled 6.3 percent of GDP in 2000. Under CBO's ten-year baseline forecast, it will fall to 5.1 percent of GDP. That is, it would fall by 20 percent relative to the size of the economy and by 10 percent in per capita terms. It would be more plausible to project real discretionary spending growth at the same rate as the population. Tweaking the baseline this way would raise discretionary spending by $359 billion and, counting the added interest on federal debt, would reduce available surpluses by about $418 billion. A perhaps more realistic baseline would allow discretionary spending to grow at the same rate as GDP. This would raise spending by $905 billion and reduce the available surplus by $1,055 billion.

Note, too that baseline revenues are likely to fall short for two reasons. First, Congress assumes that all expiring tax subsidies are in fact allowed to expire, even though in the past almost all have been routinely extended. Second, the alternative minimum tax (AMT) was created to punish a small number of wealthy who were considered too aggressive in pursuing tax shelters. Since the AMT is not inflation-indexed, however, the taxpayers affected will rise to 20.7 million in 2011. Few savvy politicians believe it will remain unchanged. "Current policy" would thus be better represented by indexing the AMT for inflation – which reduces the projected surplus by at least another $130 billion.

Removing the Social Security trust fund surplus, the Medicare trust fund surplus and the government retirement funds surplus leaves an "on-budget" surplus of $2.3 trillion (see Table 3). Adjusting for the AMT and expiring tax provisions reduces the available surplus to $2.1 trillion. If discretionary spending were held constant as a share of GDP, the remaining available surplus would be about $1 trillion. Thus, depending on what is considered the most reasonable assumption regarding current policy toward discretionary spending, the available 10-year surplus before the tax cut was between $1.0 trillion and $1.7 trillion.

How the tax cut and other policies affect the surplus

A major criticism of the President's tax cut was that the Administration was trying to force passage of it independent of the budget. Now it can be seen that these fears were well-founded (see Table 4). First, the Congressional budget resolution contains spending above the baseline of about $600 billion over the next 10 years after the interest costs are factored in. Second, allowing for the continuation of expiring provisions under current law and eliminating the gimmicky sunset provisions of the new tax law would cost an additional $523 billion over the next decade.

Third, the President has proposed an $18.4 billion increase in defense for next year. This money is mainly for salaries and health care, and should thus be considered permanent. Allowing this increase to rise with inflation and adding in the interest cost, this translates into an additional $271 billion in spending over the decade. Fourth, estimates of additional expenditures for bi-partisan education programs total about $183 billion.

All told, these items would put the non-Medicare, non-Social Security part of the budget into *deficit* by more than $400 billion over the next decade. That is, the tax cut, combined with just the programs that have been proposed to date, would require that current program expenses

be financed by dipping extensively into Medicare and social security surpluses, which a wide bi-partisan consensus in Congress has refused to do in recent years.

Beyond the Ten-Year Horizon

Under the CBO baseline assumptions about discretionary spending – constant in real terms until 2011 and constant as a share of GDP thereafter – the fiscal gap through 2070 is 0.67 percent of GDP, according to estimates by Berkeley economist Alan Auerbach and William Gale. That is, despite the current surpluses, a permanent tax increase or spending cut of 0.67 percent of GDP, which would currently be about $67 billion per year, would be needed to achieve the same national debt-GDP ratio in 2070 as currently exists. The tax cut just enacted—even if it sunsets in 2010—not only does not resolve these problems, it makes them worse. If it were extended permanently, the tax cut would roughly triple the long-term fiscal deficit over the next 70 years.

Thus, cutting taxes was not a matter of giving unneeded funds back to taxpayers. Rather, it was a choice to let future generations cover the costs of programs that current and previous generations approved, and a choice to add to those burdens by reducing current revenues.

Uncertainty

CBO's underlying economic assumptions do not appear unreasonable, but there is still huge uncertainty regarding the economy and the budget surplus. CBO reports optimistic and pessimistic scenarios, where the ten-year surpluses range from $8.8 trillion to $1.6 trillion (before the tax cut).

An important source of uncertainty stems from the assumption that the surpluses will rise over time. Only 12 percent of the projected baseline surplus occurred in the first two years, and only 36 percent in the first five years. This means that tax cuts based on projected surpluses are largely financed by funds that have not yet arrived and may never appear.

Economic Effects of Tax Cuts

Output and Efficiency

Before President Bush took office, his aides began arguing in favor cutting taxes to offset a likely recession. That raises several issues. First, is (or was) there a recession? Although the economy undoubtedly slowed, whether it entered a recession or not remains unclear. Moreover, Johns Hopkins University economist Christopher Carroll has presented evidence suggesting that the administration's rhetoric may, in part, be responsible for declining consumer sentiment and the resulting slowdown in economic activity.

Second, as Bush economic advisers Larry Lindsey and John Taylor have acknowledged in the past, tax policy is a clumsy tool for fine-tuning the economy. Recessions can come and go in the amount of time it takes to implement changes in taxes.

Third, the Bush tax bill would have provided no immediate stimulus and channeled little of the benefit to low- and middle-income families who could be expected to spend the windfall. Thanks to maneuvering by Congress, the bill was altered so that taxpayers would receive about $40 billion in rebates (technically, advance credits on their 2001 taxes) in the late summer and fall of 2001. But evidence from 1975, the last time taxes were rebated, suggests that only about half of that will be spent, resulting in a stimulus on the order of just 0.2 percent of GDP.

The Bush administration has also asserted that the tax cut will help people pay off credit card debt, and debt reduction is a form of saving. Yet, the President is also counting on the cut as an anti-recessionary device to increase consumption. He can't have it both ways.

The Administration also defends the tax cut with arguments about its long-term effects. Perhaps the most compelling is that lower marginal rates will improve efficiency and increase incentives to work and save. This argument is correct as far as it goes, but leaves out crucial elements.

The efficiency gains will be offset to some extent by the sunset provisions, which create significant uncertainty. The myriad phase-outs and phase-ins will create incentives to shuffle money over time and across activities, which will waste resources. And cutting taxes now only to raise them later (when the government has to face its long-term fiscal problems) is, on balance, inefficient.

The effect on work effort is likely to be small, both because the decline in tax rates is small and because most estimates suggest that work effort is not that responsive to tax rates. The impact on saving has also received a good deal of attention. A back-of-the-envelope calculation suggests that personal saving could rise by about 0.3 percent of GDP. The impact is this large because a substantial portion of the cuts go to high-income households, who save a larger share of their income than low-income households.

The new incentives for retirement saving could independently increase private saving, but it's hard to tell. The law could actually reduce the number of people with pension coverage because it expands the amount that business owners could contribute to IRAs and thus may make them more reluctant to start up pension plans. And there is solid reason to believe that the major beneficiaries will be high-income households, who tend to use tax-based retirement incentives more to shift savings from one pot to another rather than increasing the total.

The main point regarding saving, however, is that national (public plus private) savings is very likely to fall. Tax cuts reduce public saving by reducing the amount of money available to pay down government debt. The reduction in public saving is not fully offset by increases in private saving, because taxpayers spend a portion of the tax cut. The decline in national saving could hurt economic growth.

Distributional effects

Many conservatives dismiss discussions of tax equity as "class warfare," but the President and his economic officials have repeatedly emphasized what they view as the basic fairness of their plan and claimed the plan provides the most help to those who need it most.

There are many ways to report the size of tax cuts. Consider (see Table 5) a waitress who earns $22,000 and pays $72 in income taxes (after the child credit and before the earned income credit), plus $3,366 in payroll taxes. Compare her to a lawyer who earns $200,000 and pays $48,612 in income taxes and $15,250 in payroll taxes.

Bush's original tax cut would have reduced the waitress' income tax by $72 and the lawyer's by $8,413. Who gets the bigger tax cut? The administration would say the waitress did. Her tax cut is a larger share of her *income tax*, and she pays a smaller share of total income taxes after the tax than before.

However, reasonable observers would likely conclude that the lawyer got the larger cut. He enjoyed a bigger percentage decline in the sum of payroll and income taxes, a bigger percentage increase in after-payroll-and-income-tax wages, and, most important, a larger percentage increase in after-tax income. Needless to say, the lawyer also received a tax cut that in absolute terms is gigantic compared to the waitress's tax cut. Yet the Administration would claim the attorney gets the worst of the deal!

Of course, high-income taxpayers do pay a large share of existing taxes. However, under the new tax bill, they will receive cuts that are far in excess of the proportion of taxes they actually pay (see Table 6). The top one percent paid about 21 percent of total federal taxes in 1999, but will receive about 38 percent of the tax cut when it is fully phased in. The disparity is mainly due to the abolition of the estate tax. No justification has been presented by any tax advocate for why the share of the tax cut going to the very highest income group should exceed the share of taxes these households pay. This is especially relevant given that over the last 20 years, after-tax income has risen dramatically among the highest income groups, and by much smaller percentages in the rest of the population.

However, there is more to it than that. If the tax cut is reduces government spending, and if government spending goes mainly to lower and middle-income people, then the reduction in government spending induced by the cut would have important distributional effects and should be taken account. Thus, the new tax law is even more regressive than it looks.

Other justifications

As explained above, the most common justifications for tax cuts—their affordability, their impact on economic activity, and their counter-cyclical nature – just don't wash. But advocates have tossed out a slew of other reasons that are worth considering.

Americans are overtaxed. At 20.6 percent of GDP – up from 17.2 percent in 1992 -- tax revenues are at peacetime highs and only slightly lower than they were in World War II. The rising share of taxes in the economy is the natural result of the tax increases in 1990 and 1993, the long economic expansion of the 1990s, the rise in capital gains realizations and rapid income growth among high-income households.

However, that doesn't in itself make Americans overtaxed, or taxes too high. Revenues as a ratio of GDP remain low relative to other industrialized countries. And most families were

required to forfeit a smaller share of their income in federal taxes in recent years than in almost all of the last 20 to 30 years (see Figures 1 and 2). Aggregate tax revenues rose because income rose dramatically among households with the highest income, who also face higher than average tax rates (see Figure 3). Whether we are overtaxed is ultimately a value judgment, but the facts suggest that compared to other countries and other times, taxes on the vast majority of American households are low, and the ones who are paying higher taxes are also the ones who can most afford to do so and who have had by far the largest income gains in the last two decades.

Tax cuts are needed to restrain the size of government The claim here is that the surplus provides too much temptation for Congress to spend the funds, and that government spending is too high. This claim generates several responses. First, government spending as a share of the economy was at its lowest level in 2000 since 1966 (see Figure 4). Not counting interest payments—which are the results of previous years' policy—government spending was at its lowest share of the economy since 1957. Defense spending is at its lowest share of GDP since before World War II. Other discretionary spending—the source of most pork-barrel stories—is at its lowest share since at least 1962. Even mandatory spending is a smaller share of GDP now than 10 years ago. So it hardly seems like runaway government spending is a major issue currently.

Second, the argument that government spending is too high is distinct from the claim that some spending is wasteful. Reforming the incentives that lead to government waste is a laudable objective, but absent such reform one must accept the reality that some government spending will be wasteful. This reality will likely reduce the optimal level of government spending, but it does not imply that the optimal level is lower than the current level.

Third, smaller surpluses or larger deficits probably do constrain spending. Indeed, anecdotal evidence suggests that the pressure of large deficits helped restrain spending in the 1980s and that the budget rules helped restrain spending in the 1990s. But the view can be overstated. There was no sustained decline in spending following tax cuts in 1964 and 1981. And even though revenues rose throughout the 1990s, spending did not.

Fourth, as a way to cut spending, tax cuts are a fiscal gamble. About 64 percent of government spending in 2000 was for four programs: Social Security, Medicare, Defense, and net interest. Thus, a serious reduction in government spending is likely to either require that those programs be cut, which seems unlikely—Medicare and defense spending will probably rise—or require deeper net cuts in remaining programs, which is difficult to achieve politically. If taxes are cut and spending isn't, well...think back to the debt build-up in the 1980s. There is a much simpler and less disruptive way to constrain spending -- namely to reform current methods of government accounting that counts trust fund assets but not liabilities and have other problems. We come back to this point later.

Tax cuts are needed to avoid paying off the public debt. Alan Greenspan's argument, repeated by tax cut advocates, is that without a tax cut, marketable government debt would all be paid off around 2006. This, advocates say, would interfere with the private economy by forcing the Treasury to amass private securities, while the lack of marketable government debt would make securities markets less efficient.

A tax cut, however, is not the only—or even the best—way to increase the government's marketable debt. Tax cuts increase the government's long-term liabilities (that is, the long-term fiscal gap). A better approach would be to increase the government's marketable debt without increasing its long-term liabilities. For example, government trust funds currently holding marketable government debt could invest in other assets instead. Or the government's existing implicit liabilities (like future social security benefits) could be converted into explicit liabilities. This is the essence of another of President Bush's campaign proposals, to siphon payroll taxes into private accounts. By transferring tax revenues to private accounts meant to offset reductions in future Social Security benefits, the government would be increasing its marketable debt but reducing its unfunded Social Security liability at the same time. In any case, the prospect of shrinking debt markets does not justify a tax cut any more than it would justify a spending increase.

Conclusion

Although Bush called his plan a "a tax cut with a purpose," the purpose kept changing while the tax cut stayed the same. Remarkably almost every event or cause seemed to justify not only a tax cut in general, but a particular tax cut designed in November, 1999 to fend off Steve Forbes' challenge for the presidential nomination. In the end, there was little coherent rationale, either for a large tax cut in general or for the particular types of cuts that Bush advocated.

The biggest cost of the tax cut could prove to be the missed opportunities. Readers trying to assess the situation might consider which social or economic problems they would have addressed if they had $1.7 trillion to allocate over the next decade. The Administration chose to give more than one-third to the richest 1 percent of taxpayers and more than 70 percent to the richest 10 percent. Alternatively, the funds could have been directed toward smoothing the way for Social Security and Medicare reform, simplifying the tax system, helping low-income households, improving education, health care, environmental protection, public infrastructure, inner cities, and so on.

But that is water over the dam. Probably the best hope now is to repair some of the damage through tax changes that don't sacrifice more revenue and to alter the budget process to minimize the sorts of confusion that made it possible for the Bush Administration to pretend that Washington was rolling in dough.

Cleaning Up the Mess

A first task is to clarify the sunset provisions and the phase-out rules. No one really believes the entire tax cut will sunset in 2010. But leaving the resolution hanging creates gratuitous uncertainty that hampers tax planning and efficient economic responses.

A second task is to spare the middle-class any contact with the alternative minimum tax. The AMT should be indexed for inflation, deductions should be allowed for dependents and state and local taxes, and all personal credits should be available against the AMT.

A third is to change the credits that phase out across different income ranges. The phase-outs create hidden taxes over the phase-out range, and diminish the effectiveness of the credits in encouraging the activities they are designed to spur.

A fourth is to consolidate tax provisions with similar purposes. For example, it makes sense to combine features of the tax code that subsidize children – the earned income tax credit, the dependent exemption, the child credit and alike. Several recent proposals would coordinate the three tax subsidies, adopting a common definition of "qualifying child" that would make taxes simpler for low-income households. Much the same could be said for the myriad programs subsidizing college education and retirement savings, as well as the numerous tax rates facing capital gains.

Learning from Mistakes

But the single most important policy choice Washington could make would be to develop a budget that better describes the government's true fiscal status. Many of the problems with the current system are described above. Retirement trust funds are recorded on a cash flow basis. Projections of current spending and tax policy are unrealistic and there is no accounting for levels of uncertainty. There is no adjustment to the baseline for uncertainty.

A few changes could make a big difference. The first involves the baseline budget calculation. Congress should remove accumulations in trust funds for Social Security, Medicare and government pensions from the baseline budget, and reaffirm its commitment not to spend these resources on anything other than previously legislated benefits. The baseline could also provide more realistic projections of policy by adjusting discretionary spending for population growth, by assuming that temporary provisions will be extended and by stipulating that the percentage of tax filers facing the AMT will not be allowed to grow.

The second change would set some of the baseline surplus "off limits" for allocation to new tax and spending programs in case tax and spending projections are not realized. Robert Reischauer, currently the President of the Urban Institute and formerly the Director of the Congressional Budget Office, has proposed that Congress should commit only a portion of future surpluses to tax cuts or new spending, with the percentage lower for surpluses farther in the future. The Reischauer rule would essentially wall off some portion of future surpluses. This would limit the extent to which each party felt it had to spend future surpluses before the other one did, and would recognize that uncertainty rises with the time horizon and that policy reversals may prove difficult.

The third change would improve estimates of the costs or benefits of new tax and spending initiatives to prevent manipulation of the 10-year budget estimates. Stipulating that all tax or spending programs must be scored as fully phased in within, say, five years would allow time for adjustment but would ensure that 10-year costs remain valid indicators of the long-term effects. Temporary tax or spending policies should be scored as permanent, and the costs of tax changes should include the cost of changes in the AMT to ensure that the tax cut does not raise the number of AMT filers. Finally, including the interest costs due to higher federal debt

associated with higher spending or lower taxes would provide a truer measure of the cost of the plan.

The current debate started from the premise that with a $5.6 trillion surplus which led to the view that the President's $1.6 trillion tax cut was easily affordable. But using the rules above, the baseline budget surplus would be $1.7 trillion over the next 10 years, and the Reischauer rule would reserve $800 billion of it against forecasting errors or rainy days. This would leave about $900 billion to play with, but the tax bill would be seen as costing more than $2 trillion. We surmise that the outcome would have been quite different.

Establishing new rules may seem like a snooze. We've just seen what an exciting alternative can mean for the country – a debate that is riddled with misinformation and a tax bill that sets new lows with regard to acceptable budget gimmicks. Let's break out the No-Doz and get to work.

Table 1
The Economic Growth and Tax Relief Reconciliation Act:
Effective Dates and Revenue Costs of Selected Provisions

Provision	Highest Annual Tax Cut	2001-2011 Tax Cut	Phase-in Begins	Phase-in Complete	Phased out By
Reduce marginal income tax rates	63.0	420.6	2001	2006	2011
Abolish estate tax	53.9	138.0	2002	2010	2011
Create 10 percent bracket	46.0	421.3	2001	2002	2011
Double child credit	26.2	171.8	2001	2010	2011
Marriage penalty	11.0	63.3	2005	-varies-	2011
Repeal restrictions on itemized deductions and personal exemptions	9.4	33.0	2006	2010	2011
Pension and IRA Provisions	6.7	49.6		-varies-	
Nonrefundable credit	2.1	10.0	2002	2002	2007
Roth 401(k)s	0.4	-0.3	2006	2006	2011
AMT Relief	4.6	13.9	2001	2001	2005
Deduction for Education Expenses	2.9	9.9	2002	2004	2006
All Provisions	187.0	1,348.6	-varies-		2011

Source: Joint Committee on Taxation JCX-50-01. "Summary of Provisions Contained in the Conference Agreement for H.R. 1836, the Economic Growth and Tax Relief Reconciliation Act of 2001". May 26, 2001

Table 2
Revenue Costs of HR 1836 The Economic Growth and Tax Relief and Recovery Act
Year-by-Year Estimates

Fiscal Years 2001-2011
[billions of dollars]

		2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2001-2011
Tax Cuts Provisions													
(1)	Marginal rate cuts	-2.0	-21.1	-21.3	-29.0	-32.8	-50.9	-59.4	-60.4	-61.7	-63.0	-19.0	-420.6
(2)	New bracket	-38.2	-33.4	-40.2	-40.3	-40.2	-40.2	-40.1	-43.4	-45.4	-46.0	-13.9	-421.3
(3)	Eliminate estate tax	0.0	-0.1	-7.0	-5.6	-7.6	-4.6	-10.2	-12.4	-13.2	-23.5	-53.9	-138.0
(4)	Child tax credit	-0.5	-9.3	-9.9	-10.6	-12.8	-18.3	-19.0	-19.4	-20.5	-25.2	-26.2	-171.8
(5)	Address marriage penalty	0.0	0.0	-0.8	-1.3	-6.1	-10.0	-11.0	-10.4	-10.2	-9.2	-4.3	-63.3
(6)	Repeal of itemized deduction limitation	0.0	0.0	0.0	0.0	0.0	-1.3	-2.6	-4.0	-5.4	-7.2	-4.5	-24.9
(7)	Repeal of personal exemption phaseout	0.0	0.0	0.0	0.0	0.0	-0.5	-1.0	-1.4	-1.8	-2.2	-1.3	-8.1
(8)	Education provisions	0.0	-2.5	-3.5	-4.3	-4.7	-2.8	-2.3	-2.5	-2.8	-3.1	-1.0	-29.4
(9)	Pension and IRA provisions	0.0	-1.9	-4.1	-4.5	-5.3	-5.8	-5.4	-5.2	-6.0	-6.7	-4.8	-49.6
(10)	AMT Relief	-0.2	-2.3	-3.2	-4.6	-3.6	0.0	0.0	0.0	0.0	0.0	0.0	-13.9
(11)	Miscellaneous provisions	0.0	-0.1	-0.6	-0.8	-0.9	-0.9	-0.9	-0.9	-0.9	-0.9	-0.6	-7.6
(12)	Corporate Estimated Tax Requirements	-32.9	32.9	0.0	-6.6	6.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Reduction in Taxes													
(13)	Tax Proposals = Sum of (1) - (12)	-73.8	-37.8	-90.6	-107.7	-107.4	-135.2	-151.7	-160.1	-167.8	-187.0	-129.5	-1,348.6
Interest Costs													
(14)	Interest on tax cut*	-1.9	-4.6	-8.3	-13.6	-19.3	-25.9	-33.6	-42.0	-50.7	-60.2	-68.7	-328.8
Total Budgetary Costs including Interest													
(15)	Total cost of tax cut = (13) + (14)	-75.7	-42.4	-98.9	-121.3	-126.7	-161.1	-185.3	-202.0	-218.5	-247.2	-198.2	-1,677.3

Sources:
JCX-51-01, May 26, 2001
"Estimated Budget Effects of the Conference Agreement for H.R. 1836

* Interest costs are calculated by assuming the rate of interest is the average of the three-month Treasury Bill and the 10-year Treasury Bond rates. We assume that half of the revenue reduction in a given year accrue interest costs during that year, and all of the expenditures in a given year accrue interest costs in subsequent years.

Table 3
Projected Budget Surpluses for 2002-2011
as of January, 2001

($ Billions)

	2002-2006	2007-2011	2002-2011
CBO January, 2001 Baseline	2,007	3,603	5,610
- Adjust for Retirement Funds			
Social Security[1]	1,019	1,470	2,488
Medicare	200	192	392
Gov't Pensions	198	221	419
= Surplus, adjusted for retirement funds	590	1,720	2,311
- Adjust for Current Policy			
AMT	19	111	130
Expiring Provisions	21	61	82
Real DS/Person constant	79	339	418
= Surplus, adjusted for retirement funds and current policy	471	1,209	1,681
- Further adjustment if discretionary spending/GDP constant	126	511	637
= Surplus, adjusted for retirement funds and current policy	345	698	1,044

Source: Congressional Budget Office (2001); Rebelein and Tempalski (2000); and authors' calculations.

[1] This is technically an adjustment for the whole off-budget surplus, virtually all of which is due to the Social Security Trust Fund.

Table 4
Effects of Tax Cuts and Other Policies on Projected Budget Surpluses for 2002-2011

($ Billions)

	2002-2006	2007-2011	2002-2011
CBO May 2001 Baseline	2,002	3,626	5,628
Social Security[1]	1,020	1,465	2,485
Medicare	200	192	392
Remaining Surplus	782	1,969	2,751
Economic Growth and Tax Relief Reconciliation Act	479	796	1,275
Additional Interest Payments Due to Tax Cut	72	255	327
Remaining Surplus	232	918	1,149
Additional Spending in Budget Resolution (and interest)	191	409	600
Extended Tax Cuts (and interest)[2]	53	470	523
Defense Spending not in Budget Resolution (and interest)	97	174	271
Education Spending not in Budget Resolution (and interest)	53	130	183
Remaining Surplus[3]	-162	-265	-427

Source: Congressional Budget Office (2001); Joint Committee on Taxation (2001a, 2001b); and authors' calculations.

[1] This is technically an adjustment for the whole off-budget surplus, virtually all of which is due to the Social Security Trust Fund.

[2] The "extended" tax cut assumes that all phased-out or sunsetting provisions of EGTRRA are extended through 2011, including AMT relief, and assumes that other expiring provisions in the tax law are extended through 2011.

[3] Note that this figure (a) does not include the costs of any new major weapons system acquisition or missile defense program, or any emergency spending in the future, (b) has not adjusted for the surplus in government pension funds, © has not asjusted for the projection that about 20 million taxpayers will be on the AMT in 2011, even if the extended tax cut is implemented, and (d) has not adjusted for possible reductions in future baseline surpluses due to changes in economic projections.

Table 5
Hypothetical Example: Who Gets the Bigger Tax Cut?

	Waitress[1]	Lawyer[1]
Basic Data		
Income	22,000	200,000
Payroll Taxes	3,366	15,250
Income Taxes - Current System[2]	72	48,612
Income Taxes - Bush Plan[2]	0	40,199
Measuring the Tax Cut		
Percentage Reduction in Income Taxes	100%	17%
Percentage Reduction in Payroll and Income Taxes	2%	13%
Percentage Increase in After-Tax Income	0.4%	6.2%
Share of income taxes paid before tax cut[2,3]	1.5%	98.5%
Share of income taxes paid after tax cut[2,3]	0%	100%
Share of income and payroll taxes before tax cut[2,3]	35%	65%
Share of income and payroll taxes after tax cut[2,3]	38%	62%
Tax Cut in Dollars	72	8,413

[1] Waitress is single, lawyer is married. Each has two children and takes the standard deduction.

[2] Before EITC.

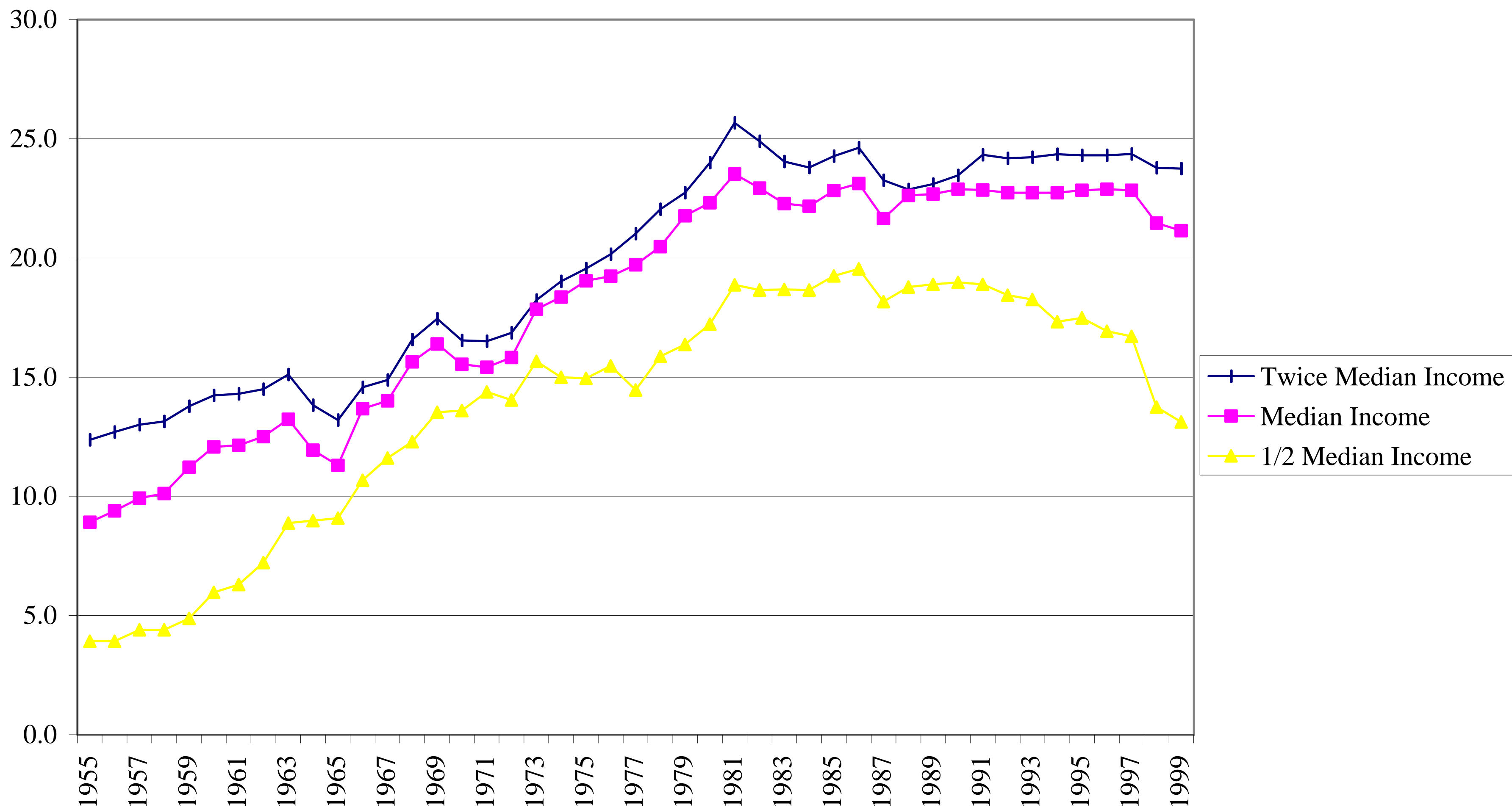
[3] Assumes there are 10 waitresses for each lawyer.

Table 6
High Income Households
Receive a Disproportionate Share
of H.R. 1836

Income Group	Share of Federal Federal Tax Burdens, 1999[1]	Share of Total Tax Cut[2]	Share of Income Tax Burden, 1999[1]	Share of Income Tax Cut[2]
Lowest 20%	1	1	-2	1
Next 20%	5	5	1	7
Middle 20%	11	9	7	11
Next 20%	19	15	16	18
Top 20%	65	71	79	64
Top 10%	49	57	63	46
Top 5%	37	47	50	35
Top 1%	21	38	29	25

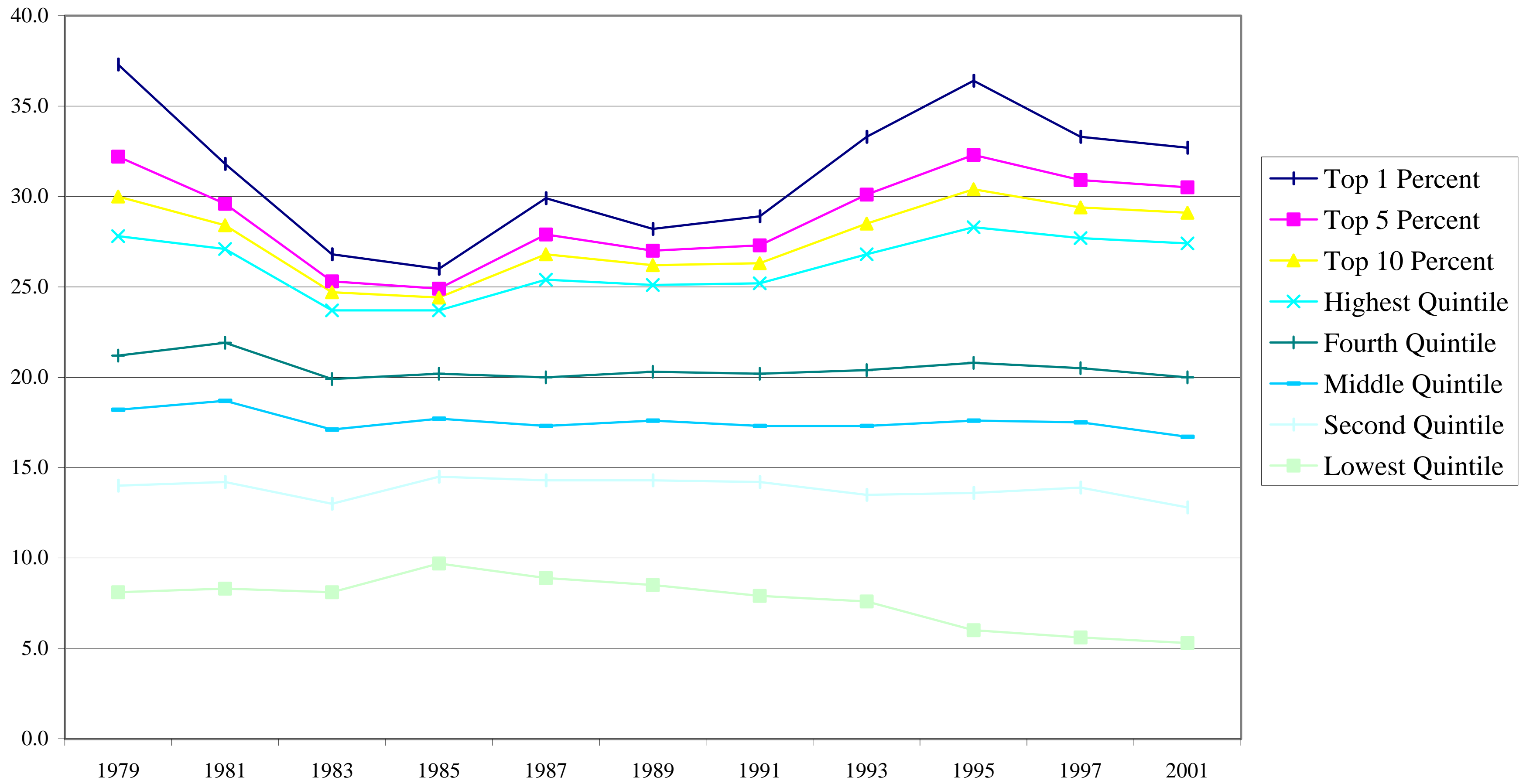
[1]Congressional Budget Office (1999).
[2] Citizens for Tax Justice (2001).

Figure 1
Average Federal Income Plus Payroll Tax Rate



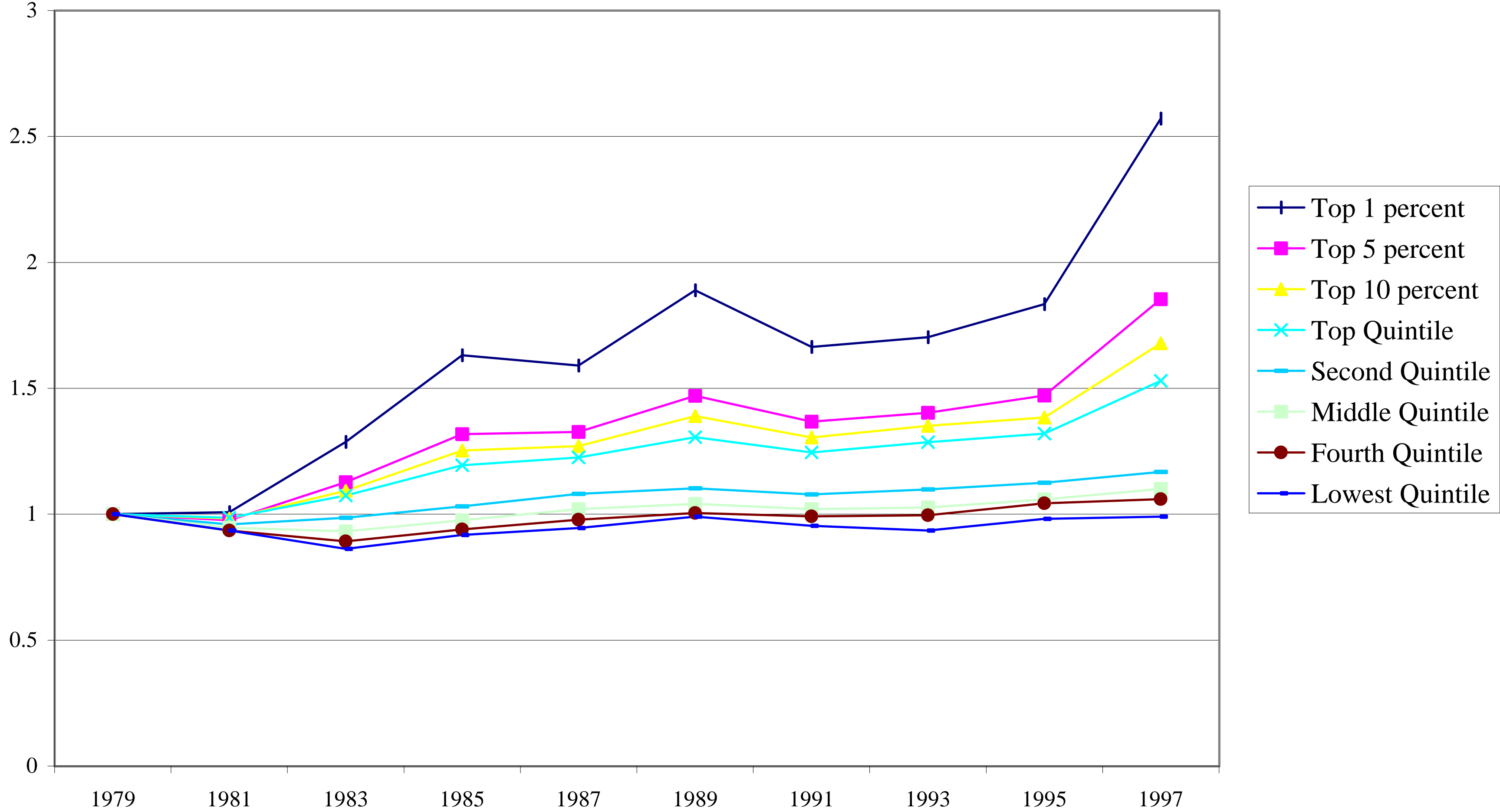
Source: U.S. Department of Treasury. 1998. Average and Marginal Federal Income, Social Security, and Medicare, and Combined Tax Rates for Four-Person Families at the Same Relative Positions in the Income Distribution, 1995-1999." Office of Tax Analysis, Jan.15.

Figure 2
Effective Total Federal Tax Rates



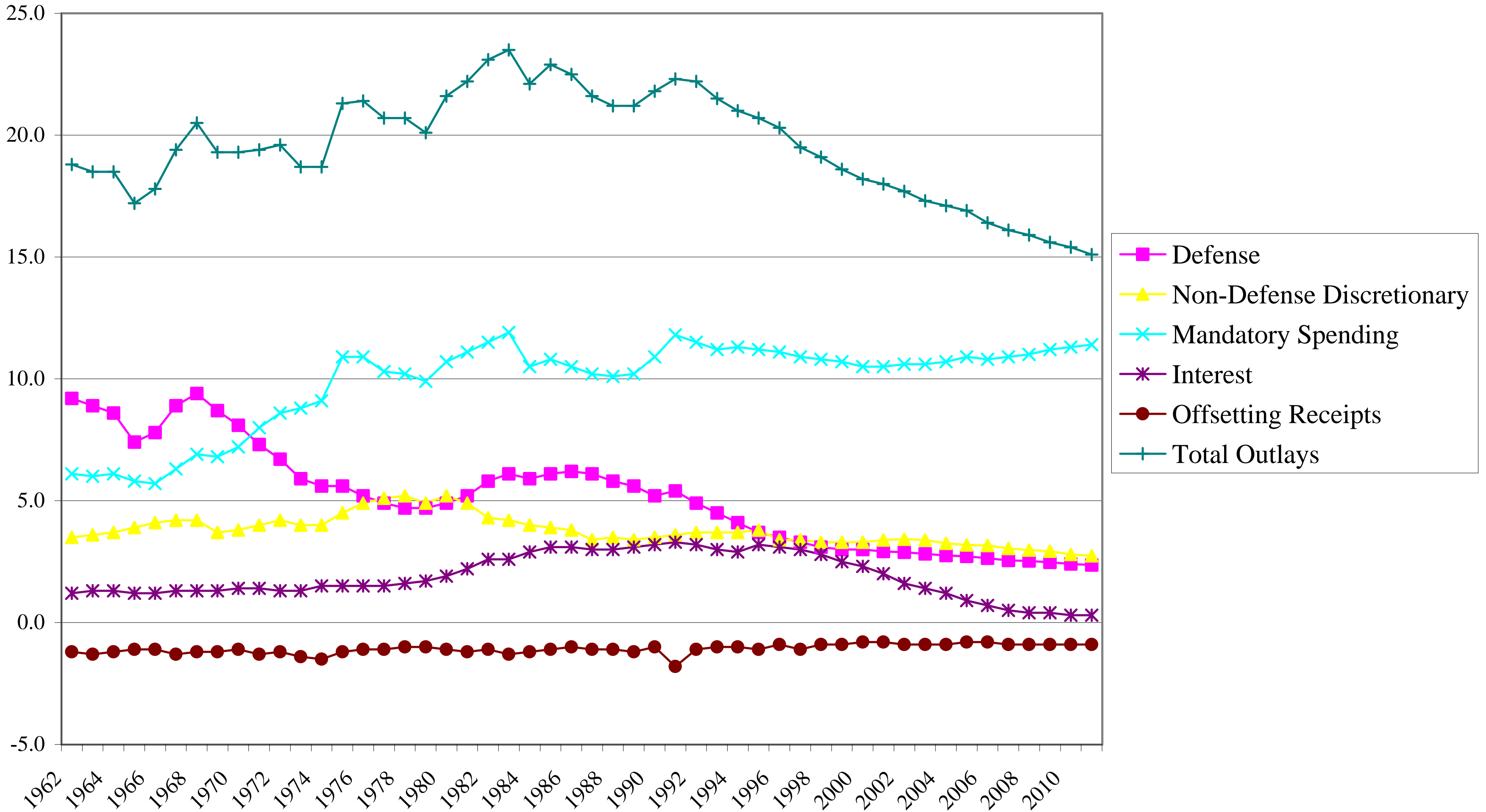
Source: Congressional Budget Office. 2001. Effective Tax Rates 1979-1997. May 2001. Table G-1a.

Figure 3
Real After-Tax Income Growth by Income Group
Indexed to 1979



Source: Congressional Budget Office. 2001. Effective Tax Rates 1979-1997. May 2001. Table G-1c

Figure 4
Composition of Federal Outlays as Percentage of GDP
1962-2011*



* 2001-2011, Projected
Source: Congressional Budget Office. 2001. The Budget and Economic Outlook: Fiscal Years 2002-2011. January.