The Budget Outlook

The Newsletter of the Senate Budget Committee Minority Staff **Volume 1, Issue 1, April 2001**

What is the AMT?

And are you willing to do your taxes twice to find out?

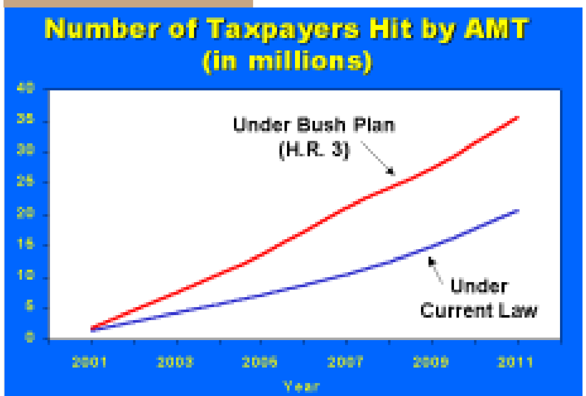

Figure 1-1
Source: Joint Committee on Taxation

MILLIONS OF AMERICAN taxpayers don't know what the AMT is and we hope they never do. But the Bush Administration's current tax plan would mean more than 30 million taxpayers would be affected by the AMT.

The AMT is the Alternative Minimum Tax, a provision of the tax code that was intended to ensure that wealthy Americans could not escape paying income taxes through the extensive use of special "tax preferences." (An early version of an AMT was first enacted in 1969, but the current AMT was established in 1986 and modified several times since then). Because of design flaws, however, the AMT will increasingly apply to middle-income taxpayers, particularly families with children.

> *The JCT estimates that if the income tax cuts proposed by President Bush are enacted, 35 million taxpayers (almost a quarter of all filers) will have bigger tax bills due to the effects of the AMT.*

This year fewer than 2 million taxpayers are affected by the AMT. But, according to the Congressional Joint Committee on Taxation (JCT), by 2011 almost 21 million taxpayers will pay more in taxes because of the AMT if there are no changes in tax laws. Furthermore, the JCT estimates that if the income tax cuts proposed by President Bush are enacted, the number of taxpayers who are affected by the AMT will be much larger, with 35 million taxpayers in 2011 (almost one quarter of all filers) having bigger tax bills due to the effects of the AMT.

How Does the AMT Work?

The AMT requires certain taxpayers to calculate their tax liability in two ways: first, under the provisions of the regular income tax and then under the AMT. In effect, taxpayers pay whatever amount is higher. But even if taxpayers aren't forced to pay the AMT, they may still be limited in their use of certain tax credits that would otherwise bring their tax liability below the AMT floor. (A temporary provision of the law that allows taxpayers the full use of these credits expires at the end of this year.) So taxpayers will be required to do their taxes twice, and then pay the higher amount.

Why Will the AMT Affect an Increasing Number of Taxpayers?

The AMT will affect increasing numbers of taxpayers primarily because the key features of the regular income tax are adjusted for inflation and the features of the AMT are not. Because the personal exemption, standard deduction, and tax brackets of the regular income tax are indexed for inflation, a taxpayer whose income just keeps pace with inflation generally will continue to face the same tax rates and owe the same amount in real (inflation-adjusted) terms under the regular income tax. But because the AMT exemption amounts and tax bracket break points are not indexed, that same taxpayer will face higher rates and increased taxes in real terms under the AMT provisions. The JCT last year estimated that indexing the AMT exemption amount would keep the number of taxpayers subject to the AMT relatively constant. But such a change in law could cost more than $100 billion over the next decade.

Why Would the Bush Tax Cut Increase the Number of Taxpayers Affected by the AMT?

Any reductions in the regular income tax will increase the effect of the AMT unless those changes are accompanied by reductions in the AMT. President Bush proposes various changes in the income tax – including lower rates, an increase in the child credit, and a reduc-

(continued on page 4)

Medicare Trust Fund Surpluses: Do They Really Exist?

Total Medicare Deficit:
Table III-1 from *A Blueprint for New Beginnings*
(in billions of dollars)

	2002 Estimate	Total 2002-2011
HI Income	181	2,410
HI Spending	147	1,884
HI "Surplus"	34	526
SMI Premiums	26	376
SMI Spending	112	1,547
SMI Deficit	-86	-1,171
Total Medicare Deficit	-52	-645

Figure 2-1
Table III-1 from page 14 of President Bush's "A Blueprint for New Beginnings" shows the Medicare HI surplus to be $526 billion over the next ten years.

THE BUSH ADMINISTRATION has been ducking for cover ever since it declared its intention to place the Medicare Trust Fund surpluses in a "contingency fund," which could be spent on other priorities. To fend off attacks, Administration officials and some of their allies on Capitol Hill have been pushing the fiction that Part B of the Medicare program, the Medicare SMI Trust Fund, is in "deficit," so there is nothing really there in Part A of the program, the Medicare HI Trust Fund, to protect. At an appearance before the Senate Budget Committee on March 6, Health and Human Services Secretary Tommy Thompson acknowledged that the Administration would in fact place the Medicare Part A surplus in President Bush's "contingency fund." "That's true," stated Thompson. But Thompson went on to explain that "the Administration does not believe you can just segregate Part A, that you have to put together both [the HI and SMI trust funds]. And when you put them both together, there's not a surplus to wall off." A day later, before a hearing of the House Budget Committee, Thompson reaffirmed the Administration's position on the treatment of Medicare surpluses saying: "The President believes that we should take a look at the total Medicare package, both Part A and Part B. And that he does not feel that you can just separate and say that you've got a surplus in one."

That argument defies logic, the history of the program, current law, statements of the Medicare Trustees, and the CBO Economic & Budget Outlook. In reality, the Part A Trust Fund does exist – and will be in surplus through 2029, according to the Medicare Trustees report issued March 20 – and the Part B Trust Fund is not in deficit. CBO's Budget Outlook (see Figure2-2) shows a Part A surplus of $393 billion over the next ten years. By its own accounting, the Bush Administration's OMB shows a Part A surplus of $526 billion over the same period (see Figure 2-1).

When Medicare was enacted in 1965, two programs were created: a compulsory hospital insurance plan for inpatient hospital and some nursing-home care – Part A – and a voluntary plan that covered doctor bills and other outpatient care – Part B. Part A was conceived as an extension of the Social Security program and, like Social Security, is financed primarily through a 2.9 percent payroll (FICA) tax. Spending HI surpluses on other national priorities, as would likely happen if left in an unprotected "contingency fund," would move up the insolvency date of the HI fund and would deplete resources needed to fund future Part A benefits.

Part B was conceived as a voluntary program with cost-sharing between the Federal government and beneficiaries. Part B benefits are financed through a combination of monthly premiums paid by current enrollees – which cover about 25 percent of program costs – and general tax revenues – which cover the other 75 percent of program costs. The Bush Administration and its defenders have been calling this the Medicare Part B "deficit." But that is a ludicrous characterization. The Part B expenses were always intended to be partially funded out of general revenues and the program will be fully "solvent" as long as we continue to do so. ■

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Figure 2-2: *Table 1-7 on page 19 of CBO's Budget Outlook shows that Medicare Part A will have a surplus of $393 billion over the next ten years.*

Table 1-7.
Trust Fund Surpluses (By fiscal year, in billions of dollars)

	Actual 2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Medicare												
Hospital Insurance (Part A)	30	29	36	39	41	40	44	41	41	39	37	34
Supplementary Medical Insurance (Part B)	*	-5	-1	-1	-1	*	3	2	2	3	3	3
Subtotal	30	24	35	39	40	40	47	43	43	42	40	38

How Much Debt Can We Pay Down?

ARE WE REALLY in danger of paying off the public debt too fast? This possibility was raised by Alan Greenspan at his Senate Budget Committee testimony in January. The Bush Administration has argued that we are limited in how fast the debt can be paid down by the fact that $1.2 trillion of debt will not be available for redemption in 2011 without paying unacceptable premiums to induce people to surrender that debt.

In fact, however, the amount of debt that would be hard to redeem may well be less than $500 billion in 2011. Moreover, a debt reduction path associated with preserving the Social Security and Medicare surpluses would not confront the "problem" of running out of debt to retire until 2010 under CBO assumptions. With the uncertainties in the economic and budget projections, it could be later than that.

In his Senate Budget Committee testimony, Federal Reserve Chairman Greenspan noted that something in excess of $750 billion of the debt held by the public (outside the Fed) either matures after 2011 or consists of nonmarketable assets like savings bonds or special bonds held by state and local governments. So why does the Administration assume that $1.2 trillion of debt will still be outstanding in 2011? Because it assumes that there are no further buybacks after 2001 and that the Treasury issues new long-term debt even as the total debt is being shrunk. The CBO estimate of $818 billion is closer to Greenspan's because it assumes that the Treasury continues to buy back some debt before it matures and stops issuing new long-term debt.

But the figure could be still lower. Gary Gensler, who was in charge of debt management and the successful debt buyback program in President Clinton's Treasury, has argued that the Treasury has available to it a number of policy alternatives to shrink the amount of longer-maturity marketable debt significantly and smoothly over the next ten years. Gensler argues further that the Treasury could reduce a significant amount of its nonmarketable debt as well. The bottom line is that the $3.4 trillion of public debt outstanding in 2000 could be shrunk to $500 billion or less over the next ten years.

The Administration argues that its estimate of debt that would be hard to retire is similar to that of the Clinton Administration's January budget and that we would have to pay large premiums to redeem any more than that. In fact, the Clinton estimate was simply a "current services" estimate that did not presume to make debt management decisions for the incoming Administration. Moreover, some experts question whether there will be a prohibitive payment premium associated with a more accelerated debt paydown schedule. ■

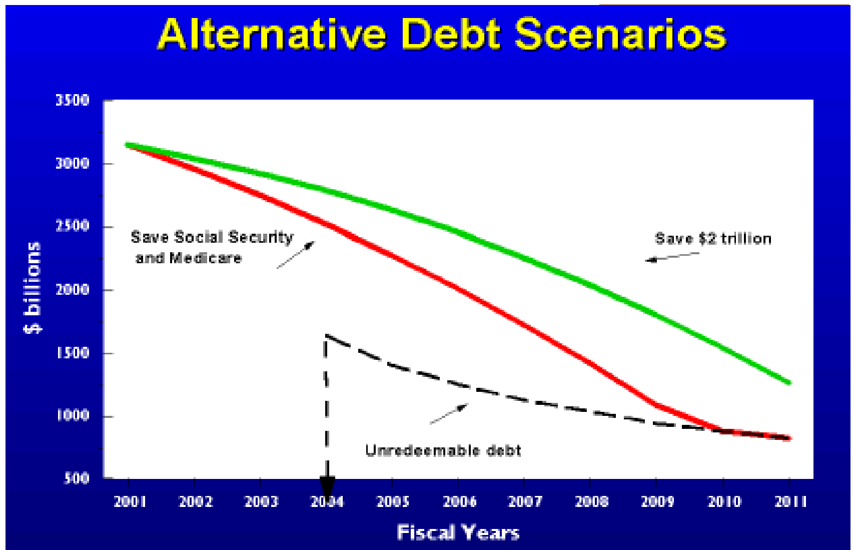

Figure 3-1

The Thompson Flip-Flop

THOSE WATCHING the budget debate closely probably picked up on the notable flip-flop done by Health and Human Services Secretary Tommy Thompson in his testimony before the House Ways & Means Committee on whether or not the Bush Administration would use the $526 billion Medicare Part A Trust Fund surplus to help fund a prescription drug benefit.

Other than Thompson's March 14 testimony, the Administration has made it clear it would consider using part of that Medicare surplus to help fund the drug benefit. Yet, in his testimony, Thompson appeared to reverse this position, claiming that the Administration had no intention of using the Medicare surplus for that purpose. Thompson stated: "The $526 billion, the law is quite clear . . . the law says that the money that goes into the trust fund is a credit to the trust fund plus interest, and it's going to be used for Medicare." When pressed further, Secretary Thompson somewhat clarified his position by saying that the Administration was "hoping" that any additional resources that would be needed for a prescription drug benefit would come from "extra money in the contingency fund, between the $526 billion and the $842 billion," or in other words, not from the Medicare surplus.

On the other hand, Thompson did try to leave himself some wiggle room by attempting to distance his position from that of the White House, stating: "I'm coming as the Secretary of Health and Human Services. And I'm telling you my position." Was the Secretary testifying on behalf of the Bush Administration, or not? ■

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AMT *(continued from page 1)*

tion in the marriage penalty – that would reduce taxes owed under the regular income tax. But other than proposing to extend the expiring provision that allows taxpayers to take full advantage of personal tax credits regardless of the AMT, he has not proposed any changes in the AMT. As a result, many taxpayers will find that a significant portion of the tax cuts they would purportedly receive as a result of the lower rates and other changes in the regular income tax proposed by the President will be taken away by the AMT.

The JCT has estimated that the President's proposals would increase the number of taxpayers affected by the AMT in 2011 by about 15 million, to a total of about 35 million, and that it would cost an additional $292 billion over 10 years to ensure that the full benefit of the Bush rate cuts are actually realized by taxpayers. So reserve your accountant now, unless you feel like doing your taxes twice every year. ■

The Short-Sighted Critics

IN AN EFFORT to justify the Bush Administration's plan to raid the Social Security and Medicare Trust Funds, critics of Senator Conrad's Social Security and Medicare Off-Budget Lockbox have been touting the hollow argument that the Conrad lockbox will result in too much debt being paid down.

It is true that the lockbox offered by Senator Conrad, which received more votes than an alternative offered by Senators Sessions and Domenici, would have precluded use of the Social Security and Medicare Part A trust funds for any unrelated purpose. But according to the Congressional Budget Office, that policy would not bring debt to irreducible levels until the year 2010.

Knowledgeable budget observers understand the uncertainty of 10-year budget forecasts and realize we may never reach the "problem" of surplus cash, particularly if Congress passes a tax cut anywhere close to the President's massive multi-trillion dollar proposal. But we digress...

Contrary to critic's attacks, saving the Social Security and Medicare surpluses does provide important benefits. It helps the economy to grow and it helps free up resources to finance promised future Social Security and Medicare benefits.

Close observers also realize that Senator Conrad's budget plan reserves surplus dollars for dealing with transition costs of long-term entitlement reform in Social Security and Medicare, not just for additional debt reduction. Since it will be impossible to achieve a bipartisan solution to long-term fiscal challenges if funds are not available to cover those transition costs, the 1/3 plan would actually help promote entitlement reform, rather than hamper it. ■

Thank you for taking a look at the first issue of the *Budget Outlook*. We look forward to regularly sharing information and addressing key issues regarding the nation's budget.

Sincerely,

Kent

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