

INFORMED BUDGETEER

A 4% OR 7% SOLUTION?

- The President's FY 2002 budget emphasized the need to maintain an overall discretionary spending level for 2002 that was "reasonable, but restrained." The President's budget proposed that discretionary spending grow by \$26 billion between 2001 and 2002, a 4% growth rate.
- The President's budget also emphasized that discretionary spending had grown by 6% on average over the last three years, and by 8% alone between 2000 and 2001. "If growth continued at a 6% pace going forward, an additional \$1.4 trillion of the surplus would be consumed over 10 years – approximately the amount of the President's tax cut." A Blueprint for New Beginnings, Feb. 28, 2001 (pg.23).
- With the submission of the President's FY 2002 defense budget amendment last week requesting an additional \$18.4 billion in discretionary budget authority for defense, where does the 4% solution stand? Interestingly, we are at 5.9% according to the *Bulletin's* estimates. (See table below.)

Comparison of 2001 and 2002 Discretionary BA with the President's Defense Budget Amendment (\$ in Billions)			
	2001*	2002	% Change
Total Discretionary BA	641.649	661.300	3.1
Defense BA	317.026	325.070	2.5
Nondefense BA	324.623	336.230	3.6
Plus President's Defense Amend.			
Defense Amendment BA	0	18.400	
Defense BA	0	18.400	
Nondefense BA	0	0	
Total Discretionary BA+ Defense	641.649	679.700	5.9
Defense BA	317.026	343.470	8.3
Nondefense BA	324.623	336.230	3.6

SOURCE: Senate Budget Committee

* The 2001 Estimate is CBO's May 2001 baseline plus the Senate reported supplemental.

- But clever budgeteers will note that the base for calculating the 5.9% growth figure has been increased to account for the Administration's FY 2001 supplemental request of \$6.5 billion. The supplemental was not contemplated at the time of the President's initial budget submission. So apples-to-apples comparison, one could conclude that the original 4% proposal is now really a 7% increase.
- And we have only begun the 2002 appropriations process!

DEFENSE BUDGET TO BE INCREASED BY \$245 BILLION

- Last Friday, Secretary of Defense Rumsfeld released the essentials of President Bush's 2002 budget amendment for the Defense Department. After several months of review, the Administration determined to increase the 2002 DoD February's "place holder" budget by \$18.4 billion. The increases target pay & housing (\$4.1 billion), the Defense Health Program (\$2.0 billion), readiness (\$8.1 billion), modernization (\$3.6 billion), an intelligence program (\$850 million), and missile defense (\$600 million). There is also a set of offsets totaling \$922 million.
- This additional \$18.4 billion brings President Bush's 2002 National Security budget function to a total of \$343.2 billion – a \$33 billion increase over the \$310.3 billion enacted, to date for 2001. It is also \$34.2 billion above the total for National Defense requested by former President Clinton for 2002 in his last defense budget proposal, submitted in January 2000.
- If the \$5.8 billion requested by President Bush for the Defense Department in the 2001 Supplemental is enacted, a comparison

between President Bush's defense budget and the last one submitted by President Clinton shows an even wider gap. If both the 2001 supplemental and the 2002 budget amendment are enacted as requested, the difference between President Clinton's requests for National Defense for 2001-2002 and President Bush's proposals grows to significantly over \$40 billion. If one looks at the difference between President Bush's ten year National Defense budget (for 2002-2011), as amended, and President Clinton's last ten year defense budget, the difference is \$245 billion.

Comparison of Clinton and Bush Defense Budgets^a (BA, \$ in Billions)			
	2001	2002	2002-2011
Clinton Plan ^b	305.3	309.0	3,459.9
Revised Bush Plan	316.1	343.2	3,704.6
Bush compared to Clinton	10.8	34.2	244.8

SOURCE: Senate Budget Committee

/a The table shows only BA. As this *Bulletin* went to press, revised outlay estimates

for the amended Bush budget were not available.

/b The last Clinton National Defense budget was for the years 2001-2010. For purposes of display and analysis here, a figure for 2011 was calculated using an average inflator from the Clinton budget for the years 2001-2010.

- Some have attempted to make the argument that President Bush and Vice President Cheney have not kept their promise to the armed forces during the presidential campaign in 2000 that "help is on the way." During that campaign, candidate Bush pledged to increase the defense budget by \$45 billion over ten years. In just two budgets, he has already kept almost all of that pledge. Thus far, for ten years, he has exceeded that pledge by 444%. During that election campaign, Vice President Gore promised to increase defense by \$100 billion over ten years. President Bush will exceed that by 145%. And, there is every indication that the 2003 defense budget from President Bush will contain still more increases.

SPECTRUM SAGA CONTINUES

- A recent decision by the Court of Appeals for the District of Columbia Circuit in *NextWave v Federal Communications Commission*, could reduce the on-budget surplus by as much as \$12.2 billion in 2001 and threaten the viability of the FCC's spectrum auctions. How did this happen?
- A brief review: To comply with a requirement in the spectrum auction law, the FCC in 1996 conducted an auction solely for small businesses that met certain criteria. That auction—called C block—yielded \$10.2 billion in high bids, but not cash to the Treasury (except for \$1 billion from 10% down payments). The terms of the auction allowed winning bidders to repay the FCC the 90% remaining from their bid over 10 years, including interest.
- After making the initial down payment, several winning bidders encountered difficulty raising capital and sought new repayment terms from the FCC, which offered a variety of options in several steps. Although some bidders employed these options, others declared bankruptcy. The largest of these was NextWave, which accounted for \$4.7 billion, or nearly half of the original high bids. The FCC canceled the licenses of bankrupt bidders for non-payment and proceeded to prepare to reacquire them.
- NextWave convinced a bankruptcy judge to lower its net obligation to the federal government to about \$1 billion, but the FCC appealed, and the 2nd Circuit Court of Appeals ruled that the FCC could revoke and reacquire the licenses NextWave sought to hold onto.
- In auction 35 that ended on January 26th of this year, telecommunications companies bid nearly \$17 billion for the rights to use the spectrum sought by NextWave. The expected payments from this auction are subject to credit reform procedures and are considered a recovery on the loans made by the FCC to

the original C-block licensees. Credit subsidies, which are classified as mandatory, are estimated annually and are adjusted to reflect the most recent information on the cash flows being generated by the licenses. OMB estimated that the present value of payments from auction 35 were \$12.2 billion higher than expected. The \$12.2 billion credit subsidy reestimate was included as a negative outlay in both OMB and CBO's projections of the surplus under current law for 2001.

- **Recent Developments:** Just as Treasury was preparing to record the credit subsidy reestimate of \$12.2 billion, and despite the 2nd Circuit's decision, the DC Circuit decided in favor of NextWave. The Court found that the Bankruptcy Code prohibited the FCC from cancelling NextWave's licenses.
- The FCC has 45 days to decide whether to ask for a hearing en banc and then 60 days after that to appeal any decision to the Supreme Court. If the FCC decides not to appeal, or if the FCC loses in the Supreme Court, the FCC could be forced to settle with NextWave in the Bankruptcy Court. Under this scenario it is unlikely that taxpayers would ever receive anything close to the \$17 billion that auction 35 indicated the licenses are worth—remember that one bankruptcy judge estimated their value at \$1 billion.
- Meanwhile, OMB and the FCC must decide whether Treasury should record the negative \$12.2 billion credit subsidy reestimate in 2001. The DC Circuit Court decision increases the uncertainty regarding the expected value of future payments from auction 35. OMB could reduce the subsidy reestimate recorded by Treasury to reflect this uncertainty. OMB also could tell Treasury to record the entire \$12.2 billion if they expect the FCC to prevail. Finally, OMB could postpone any action until a final decision is reached.
- The Administration's decision on how much of a credit subsidy reestimate to record and when to record it will have a big impact on the surplus. If those funds are not recorded in 2001, the estimated on-budget surplus, less the HI surplus, will slip from \$12.7 billion to \$0.4 billion, because OMB and CBO both have included the \$12.2 billion negative outlay in their baselines.
- Although the recording of receipts under credit reform may seem capricious, ultimately the sum of all credit subsidy reestimates must reflect the total amount of cash received by the government for the licenses. So, regardless of the Administration's decision in 2001, the FCC must ultimately prevail for the surpluses over the next 10 year to not be adversely impacted by this court decision.

FEDERAL GOVERNMENT TEETERING ON THE EDGE?

- In his last official act as Chairman of the Senate Governmental Affairs Committee, Senator Fred Thompson released a report on the most pressing management problems the Bush Administration will face in the coming years. The report, entitled "Government at the Brink," reviews what GAO and agency Inspector General studies and testimonies have said about the federal government's management challenges.
- The most critical and widespread problems throughout the federal government include the management of its workforce, where recent employee "downsizing" and an aging workforce combine to leave many agencies short of employees with the necessary skills to do their jobs. The federal government also continues to falter in its attempts to effectively and efficiently manage its financial and accounting systems as well as its information technology systems. Finally, the report highlights the federal government's propensity to operate overlapping programs as well as regulatory programs, subsidies, tax breaks and other forms of federal intervention.

- The report also lists the federal government's top ten worst examples of mismanagement. The unlucky ten include:

- 1. The Big Dig** - Boston's Central Artery, the most expensive federal infrastructure project ever, is now estimated to cost almost \$14 billion - a 525 percent increase from the original estimate of \$2.6 billion.
- 2. Trust for American Indians** - The Interior Department does not know what happened to more than \$3 billion it holds for American Indians.
- 3. DoD Financial Management** - The Defense Department is notorious for its inability to account for much of what it spends its money on.
- 4. NASA** - Poor management of its contracts and major projects by NASA has caused billions to be forever lost. Highlighted are the failed Mars Polar Lander, Mars Microprobe Missions as well as the X-33, a space traveling airplane.
- 5. Medicare** - Medicare wastes at least \$12 billion a year on improper payments.
- 6. DOE** - fails to safeguard the nation's nuclear secrets.
- 7. IRS Financial Management** - The IRS does not know how much Social Security and Medicare taxes it collects and sometimes doesn't record payments made by taxpayers for over a decade.
- 8. Veterans Affairs** - The VA's IG found that a hospital's food service shares the loading dock with the Environmental Management Service's hazardous waste containers.
- 9. Student Financial Aid** - Federal student aid programs are exposed to a great deal of fraud and abuse.
- 10. Unemployment Insurance Fund** - The Labor Department has been unable to stop fraudulent employer and internal embezzlement schemes, fraudulent interstate claims and the fraudulent collection of benefits by illegal aliens using fake Social Security numbers.

- According to Senator Thompson's report, the key ingredients required for the Bush Administration and the Congress to tackle these problems include strong political leadership from the Executive Branch as well as from Congressional leaders; agency follow-up through the establishment of specific performance goals; investing in improvements; and linking funding to results, where both the President and the Congress need to insist on reliable performance information to determine what's working and what's not, and then hold the agencies and programs accountable.

BUDGET QUIZ

- **Question:** During his recent testimony before the House Budget Committee on the Budget Enforcement Act (BEA), OMB Director Daniels stated that OMB's current assessments show that a deficit of \$121.2 billion exists on the "paygo" scorecard. If not waived or modified before the end of this fiscal year, can \$121.2 billion in non-exempt direct spending programs be sequestered?
- **Answer:** No. The BEA defines the universe of sequesterable resources, by exempting some programs (e.g. social security), limiting the sequester (e.g. Medicare at no more than 4%) and placing other restrictions on the sequestration process. In total, OMB estimates the universe of sequesterable direct spending programs is no more than \$33.3 billion – less than 30% of the current \$121.2 billion paygo deficit.
- **Bonus Question:** If the maximum sequester were ordered, what programs and how much would they be reduced this fall?
- **Answer:** According to OMB estimates, the \$33.3 billion sequester would be as follows:

Medicare	\$8.1 billion
Agriculture Price Support	\$5.9 billion
Child Support Enforcement	\$3.4 billion
Crop Insurance	\$2.6 billion
Immigration Enforcement	\$1.9 billion
Social Services Block Grant	\$1.5 billion
Veterans Education Adj. Benefits	\$1.3 billion
Crime Victims Fund	\$1.1 billion
Mineral Leasing	\$1.0 billion
Special Milk, Student Loans	\$0.2 billion
Other	\$6.4 billion