United States Senate Budget Committee

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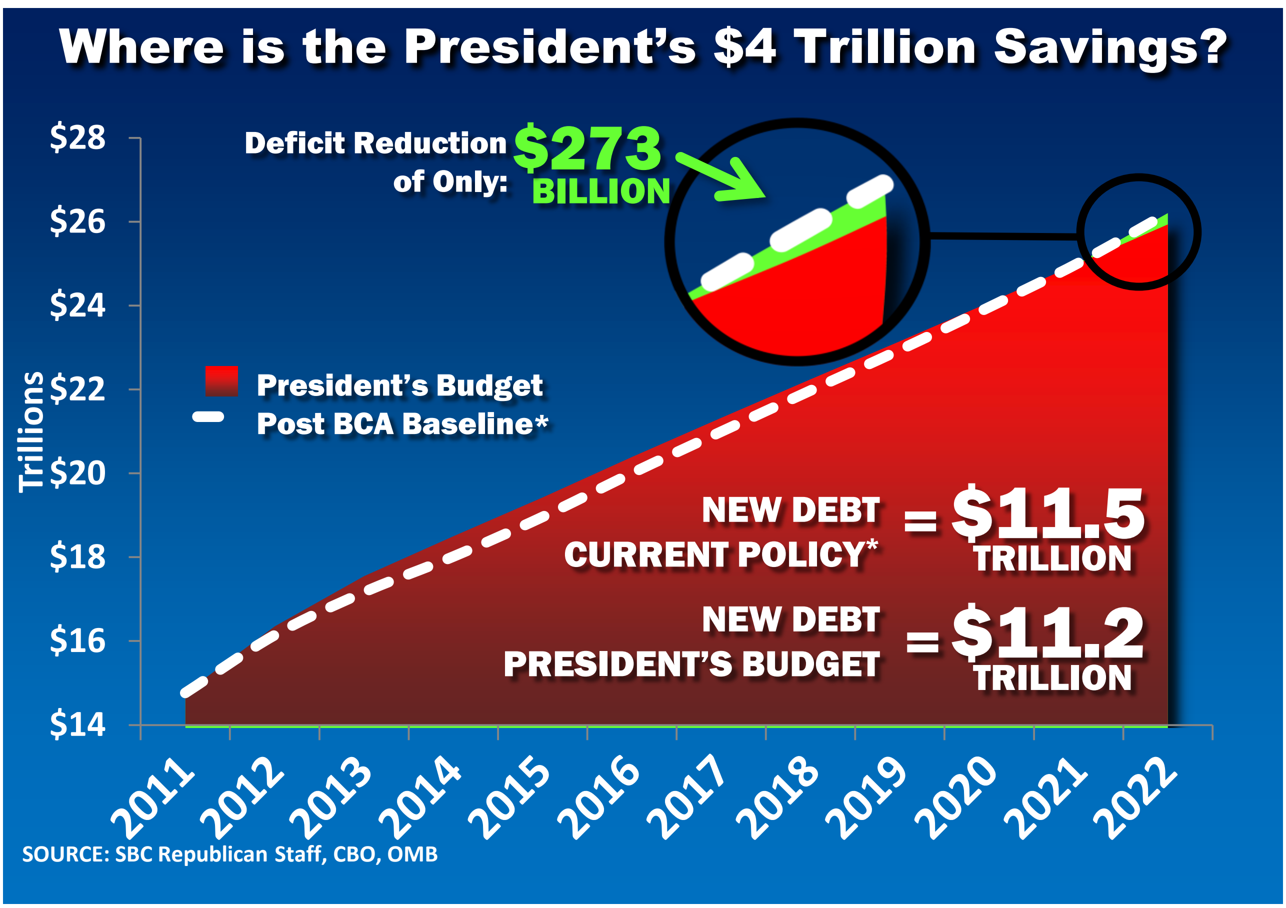
The Obama 2013 Budget:
A Summary And Analysis



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The Obama 2013 Budget: A Summary And Analysis

The president's 2013 budget claims it will result in declining deficits from **$1.3 trillion in 2012** (8.5 percent of GDP) to **$0.9 trillion in 2013** (5.5 percent of GDP) to **no less than $0.6 trillion in any subsequent year**.

The budget **fails the pledge** the president made on February 23, 2009 at his Fiscal Responsibility Summit:

> And that's why today I'm pledging to cut the deficit we inherited in half by the end of my first term in office.[1]

But that is not happening in 2012—the last year of this term. Instead, the deficit will be $1.327 trillion, which is nearly twice as high as half of ($706 billion) the deficit that occurred in his first year, and three and a half times higher than half of ($380 billion) the current-policy deficit he claimed in 2009 that he had "inherited" for this year.

The 2013 budget also **fails the test the president set** in February 2010 when he created his Fiscal Commission. Two years ago he set a goal to reduce the deficit so that it is no higher than 3.0 percent of GDP in 2015. But his 2013 budget would result in a deficit that is 3.4 percent of GDP in 2015.[2]

President's 2013 Budget Proposal

Deficits And Debt According To The President's Estimates

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Deficits														
$ trillions	1.4	1.3	1.3	1.3	0.9	0.7	0.6	0.6	0.6	0.6	0.6	0.7	0.7	0.7
% GDP	10.0%	8.9%	8.7%	8.5%	5.5%	3.9%	3.4%	3.4%	3.0%	2.7%	2.8%	2.8%	2.8%	2.8%
				fail!			**fail!**							
Gross Debt (end of year)														
%GDP	84%	93%	98%	104%	106%	106%	105%	104%	103%	103%	102%	102%	101%	101%
$ trillions	11.9	13.5	14.8	16.4	17.5	18.5	19.4	20.4	21.3	22.2	23.2	24.1	25.0	25.9

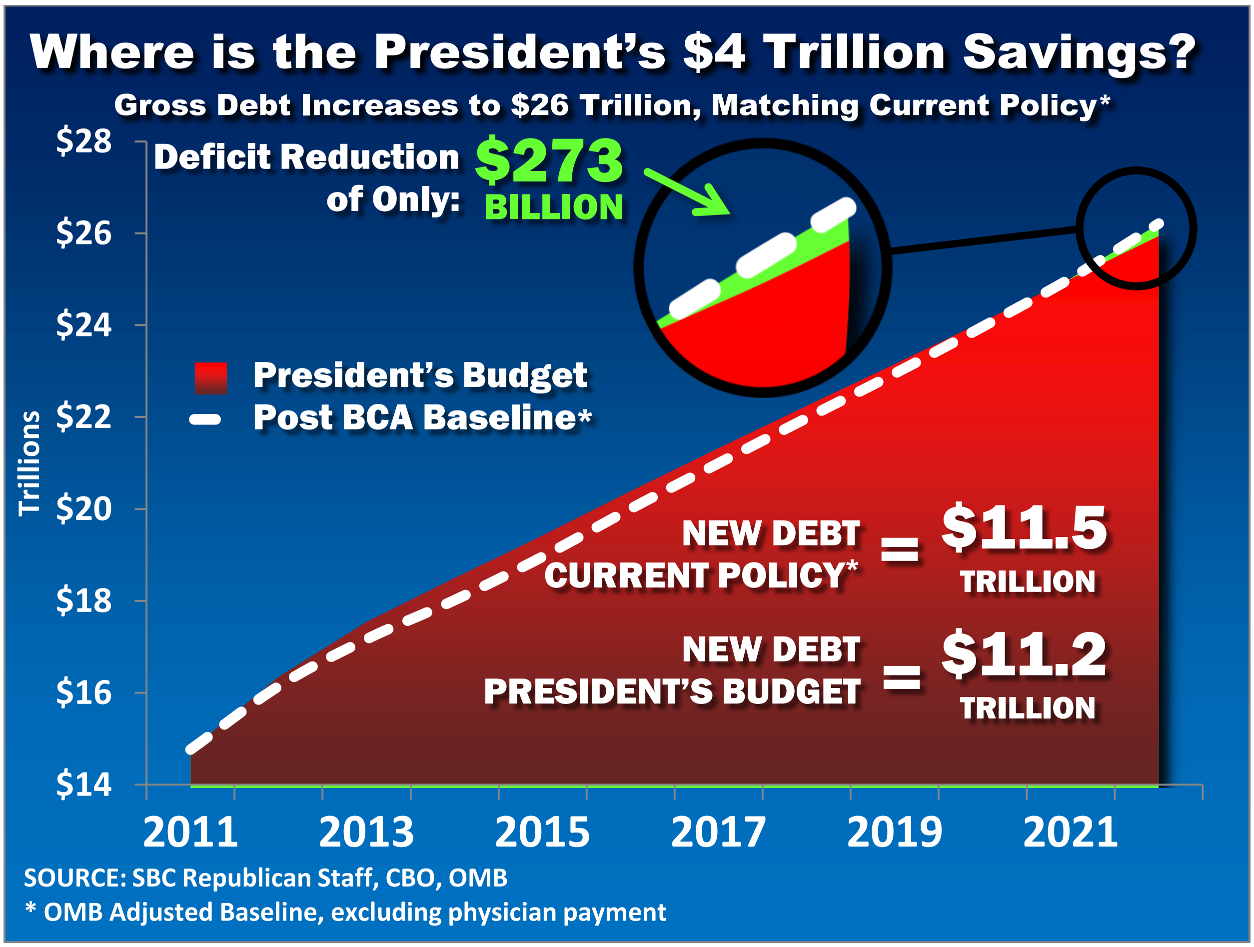
Even taking the figures in the president's 2013 budget document at face value (but knowing that CBO's analysis expected a month from now will, as usual, show higher deficits and debt

[1] It is tricky to know exactly what the President might have meant. Did he think he inherited the $1.4 trillion deficit that occurred in 2009 (even though there remained seven months left in that fiscal year and he had just signed into law his stimulus bill a week before)? Or did he mean he inherited the current-policy baseline deficit of $761 billion that he was projecting would occur in the last year of his first term (2012)?

[2] In 2010 the Administration also interchangeably claimed that the goal they set was to have the budget be in "primary balance" in 2015—where all spending except interest would match revenues. Even by their own metric, the 2013 budget fails this alternate version of the claim since "primary deficits" would persist through 2017.

associated with the president's budget[3]), **the budget does nothing to change the unsustainable trend of spending and the growth of debt.**

Under this budget package, gross debt will increase from $14.8 trillion (98 percent of GDP) at the end of 2011 to $17.5 trillion by the end of 2013 (106 percent of GDP). By 2022, debt under the president's policies will increase to nearly $26 trillion, remaining above 100 percent of GDP. The following graph illustrates the growth of job-crushing debt and how it continues to rise essentially as much under the President's proposals as it would have even after enactment of the Budget Control Act (BCA).



[3] For example, last year CBO estimated the President's 2012 budget would produce deficits of $9.5 trillion over 2012-2021 – $2.3 trillion higher than estimated by the President

President's Budget Reduces Deficit… $273 Billion— Not $4 Trillion

The president claims that his fiscal plan will reduce the deficit by $4 trillion over the next 10 years, including the previously enacted $1 trillion Budget Control Act cuts that are part of current law. An honest analysis reveals, however, that the president's budget would only reduce the deficit by about $300 billion in comparison to what was agreed to in the Budget Control Act last August. In other words, the White House utterly fails to meet even the minimum target they have identified as necessary.

The president's claimed deficit reduction is based on the following deceptions:

- It does not count the cost of replacing the $1.2 trillion sequester (spending reduction plus interest savings) required under current law. This is plainly true because the president eliminates the reductions required by the law that he signed and replaces it with tax increases. Then he fails to score the cost of repeal, a monumental deception.
- It counts the inevitable winding down of the war costs in Afghanistan—all of which is borrowed—as $1 trillion in spending reduction; and
- It buries the $522 billion cost of freezing the Medicare physician update in the baseline, without identifying any source of funds to pay for it.

A comparison of the president's math and honest math is shown below. An honest accounting shows that the president only reduces the deficit by $273 billion over ten years and, by his own estimates, increases the gross debt by approximately $11 trillion, on top of nearly $5 trillion that's already accumulated during his first three years in office.

Deficit Effect Of The President's Fiscal Plan

(2012–2022, in trillions of dollars)

President's Math	Honest Math	
-1.551[4]	-1.551[4]	Tax Increases
---	1.195	Eliminate BCA Fallback Sequester
-0.848	---	Savings from Ending War
-0.646	-0.646	Savings from Other Programs
0.354	0.354	New Stimulus Spending
0.125	0.125	New Surface Transportation Spending
---	0.438	Freeze Medicare Physician Payments
-0.407	-0.188	Interest Savings from Lower Debt
-2.973	**-0.273**	**Total**

Fiscal sleight-of-hand accounts for $3.7 trillion of the president's deficit reduction, leaving the debt in the president's plan largely unchanged from what would be expected to occur under current spending law and tax policies ($11.2 trillion rather than $11.5 trillion). Even worse, the president's proposed switch from current law spending reduction to even higher taxes contributes to a 62 percent increase in spending between 2011 and 2022. Once the gimmicks are taken away, the president's budget becomes another enormous tax-and-spend plan that ignores the drivers of our debt and is alarmingly inadequate for the undisputed fiscal realities of a growing debt and aging population.

[4] This figure includes the outlay portion of refundable tax credits. It does not include the cost of the stimulus or the receipts component of mandatory spending programs. Without these adjustments, the tax increase is $1.883 trillion.

Revenues

OMB "bonus" baseline revenues from rosy assumptions As result of more optimistic economic and technical assumptions, the Administration's baseline projection estimates nearly $1.5 trillion in additional revenue collections compared with CBO's baseline. Fifty-two percent of this amount is attributable to higher individual income taxes, 22 percent comes from corporate profits, and the remainder results from other categories of taxes. Assuming faster economic growth in the near-term boosts both the level of wage and salary income and corporate profits through 2021. Wages and salaries and corporate profits have a higher effective tax rate than other income—so the higher they are relative to the other income categories, the higher the projected revenue stream.

Tax Increases The president's big-government vision imposes a heavy cost: diminishing economic opportunity through massive tax hikes that depress wages and stifle job creation at a time when millions of Americans remain out of work. In total, the president's budget seeks $1.9 trillion in new taxes on families, small businesses, and job creators.

The budget reflects the president's pledge to raise taxes on higher income individuals. It assumes that the top marginal income tax rate rises to 39.6 percent at the end of 2012. The personal exemption phase-out and limitation on itemized deductions (otherwise known as Pease) would be reinstated. It would also raise the capital gains tax rate to 20 percent.

Although the president has talked a great deal about imposing a Buffett Rule that would tax millionaires at 30 percent, no such proposal was included in his budget. Instead, the president would treat dividends as ordinary income for upper income individuals, which would more than double the tax rate from 15 to as high as 39.6 percent. This proposal was not included in last year's budget. Considering that some high income individuals receive a significant portion of their income in the form of dividends, the Administration may be proposing this new tax treatment as a proxy for the Buffet Rule. Together, the individual income tax increase would increase revenues by $849 billion over the next ten years, according to the Administration's claims.

Once again the president has proposed capping the value of tax expenditures at 28 percent, which is estimated to raise $584 billion. This reduces the value of itemized deductions and income tax exclusions for those in the top two marginal rate brackets. The four largest tax expenditures are the health care exclusion and the deductions for mortgage interest, state and local taxes, and charity. Limiting the benefit of these expenditures will reduce spending on health care, housing, and charitable contributions. Individuals in relatively higher tax states will bear the full burden of the taxes their governments impose.

It also assumes that the estate tax rate increases to 45 percent and the exemption amount falls to $3.5 million, generating $143 billion over ten years. The exemption amount would *not* be indexed for inflation. Currently, estates are taxed at a 35 percent rate and receive a $5.0 million exemption, which is portable between spouses. The budget would limit the use of valuation discounts and grantor retained annuity trusts.

The president's budget includes other revenue raisers that were also proposed last year, such as $12 billion in additional revenues from efforts to reduce the tax gap and $142 billion in higher taxes from closing so-called loopholes like eliminating carried interest and repealing last-in-first-out accounting. His budget would also increase taxes by $19 billion on the financial and insurance industries. Proposals to simplify the tax code would actually reduce revenues $1 billion.

Despite pledging to reform the corporate tax code to make America more competitive, the president has yet to release a tax reform plan. Instead, the president repackaged a set of existing proposals from prior year budgets around making the research and development tax credit permanent that would reduce revenue by $156 billion. The budget also would double the Section 199 manufacturing deduction for advance manufacturing. However, the president included many of his proposals from last year to raise taxes on U.S multinationals that operate worldwide by reducing the benefit of the foreign tax credit and limiting deferral, which would generate $148 billion of additional revenue, thereby nearly offsetting the benefit of making the R&D tax credit permanent.

The budget also reflects a continued hostility on the part of the president towards the largest sources of domestically produced energy. The president is once again proposing a repeal of several provisions related to fossil fuels, raising taxes by $41 billion over ten years. There are also proposals to reinstate Superfund taxes and increase the Oil Spill Liability Trust financing by one cent (raising taxes a combined $22 billion). These are also coupled with a proposed fee on so-called "nonproducing oil and gas leases" that would raise nearly $1 billion and impose special assessments on domestic nuclear utilities that would total $2 billion over ten years.

Temporary Tax Relief The president proposes to extend recently enacted temporary tax relief by continuing some of the measures enacted or extended in the stimulus bill or subsequent legislation. The most significant tax proposal is the extension of the American Opportunity Tax Credit. This proposal will result in about $75 billion in forgone revenue over the next ten years. Since this credit is also refundable, another $62 billion of increased outlays is reflected on the spending side of the budget. The Administration also proposes to reactivate and reform the Build America Bonds (BABs) program that Congress decided to let expire at the end of calendar year 2010, which would increase spending $58 billion. This policy assumes that BABs gradually replaces the existing interest exclusion of tax exempt state and local bonds. Of note, the president does not propose to extend either the Make Work Pay Tax Credit or the 2.0 percent payroll tax reduction for tax year 2013.

PRESIDENT'S TAX PROPOSALS IN 2013 BUDGET

(revenue increases (+) or decreases (-) $ billions)

	2013	10-yrs 2013-22
CBO Baseline Revenue Level	**2,988**	**41,179**
OMB "bonus" baseline revenues from rosy assumptions	**138**	**1,462**
OMB Baseline Revenue Level	**3,126**	**42,641**
2001/2003 & AMT patch current tax law included in OMB adjusted baseline	**-244**	**-4,250**
OMB adj baseline	**2,882**	**38,391**
Tax increase proposals:		
Sunset the Bush tax cuts for those earning more than $250,000	56	849
Reduce the value of certain tax expenditures	27	584
Raise estate and gift taxes	1	143
Raise taxes on buisnesses operating overseas	9	148
Raise taxes on financial and insurance companies	1	19
Raise taxes on fossil fuels (coal, oil, and gas)	5	41
Close loopholes	4	142
Reduce the tax gap[a]	0	12
Simplfy the tax code[a]	0	-1
Subtotal, tax increase proposals	104	1,937
Stimulus:		
2% payroll tax reduction	-31	-31
100% bonus depreciation	-15	31
10% jobs credit a/	-12	-18
Advanced energy manufacturing tax credit	-1	-3
Energy-efficient commercial building tax credit	0	-2
Build America bonds, New Markets tax credit, Growth Zones[a]	0	58
Subtotal, stimulus	-59	35
Manufacturing and investment subsidies:		
Provide tax incentives for locating jobs and business activity in the US	0	0
Manufacturing Communities tax credit	0	-4
Target the domestic production activities deduction to domestic manufacturing	-1	-12
Make research and experimentation tax credit permanent	-7	-109
Advanced technology vehicles tax credit	0	-2
Medium- and heavy-duty alternative-fuel commercial vehicles tax credit	0	-2
Extend and modify certain energy incentives[a]	0	-3
Eliminate capital gains taxation on small businesses and expense start-up costs	0	-11
Tax credit for small employer contributions to employee health insurance[a]	-1	-13
Subtotal, manufacturing subsidies	-10	-156
Tax relief for individuals:		
Extend American opportunity tax credit [a]	-1	-75
Automatic enrollment in IRAs & double the tax credit for small employer plan startup costs[a]	0	-13
EITC and child and dependent care tax credit[a]	0	-7
Other	-1	-3
Subtotal, tax relief for individuals	-1	-95
Receipt effect of spending proposals[b]	-1	191
Other revenue effects	-14	-29
Total, net effect of budget proposals on revenues relative to OMB adjusted baseline	*20*	*1,883*
President's Budget Revenues	**2,902**	**40,274**
% of GDP	17.8%	19.2%

a. Proposal affect outlays, only the receipt effects are shown here. New spending embedded in the president's tax proposals equals $157 billion over 10 years.

b. Spending proposals that have a revenue impact like the financial crisis fee, UI reforms, and the IRS cap adjustment.

Note: Totals may not add due to rounding.

Spending

Discretionary Spending Under the Budget Control Act, OMB is required to implement a fallback sequester in January 2013 (and in each of the subsequent eight years) to produce $1.2 trillion in spending reduction if the process related to the Joint Select Committee on Deficit Reduction (a.k.a. Supercommittee) did not result in enactment of a law reducing the deficit by the same amount.

The Supercommittee did fail, but now the Administration proposes to repeal the fallback sequester and replace the required spending cuts with $1 trillion in tax increases. The failure of the Supercommittee has already resulted in OMB redefining the two categories of discretionary spending caps as required by the BCA (the "security" category now is identical to the defense budget function, and the "non-security" category is all other discretionary spending). But the president's budget proposes to amend the BCA to redefine the security and non-security categories back to the initial levels and components set by the BCA before the Supercommittee's failure. The president's request for discretionary appropriations would fit under these original caps in every year. For 2013, the caps would be re-set at $686 billion for security agencies and $361 billion for non-security agencies. (For 2014-2022 the president proposes to return to a single, overall discretionary limit.)

A comparison of non-emergency, non-war discretionary budget authority (excluding Changes in Mandatory Programs (ChiMPs) and Disaster-designated spending) shows that the president's request for the security category in 2013 would nudge appropriations up slightly from the level enacted in 2012, while the non-security request for 2013 is slightly lower than the 2012 enacted level. Some agencies, however, would see significant increases, such as the Departments of Energy and Commerce (at the expense of the Department of Housing and Urban Development, the Department of Labor, and the Corps of Engineers).

Year-Over Year Change in Discretionary Appropriations

(Budget authority, by fiscal year, in billions of nominal dollars)

	2012	2013	Change from 2012	
	Enacted	Request	Dollars	Percent
Security Agencies	684.2	686.0	1.7	0.3%
Non-Security Agencies	376.0	374.9	-1.1	-0.3%
Total, Discretionary Budget Authority (ex. War and Emergency)	1,060.2	1,060.9	0.7	0.1%

In total, the requested 2013 appropriation level still reflects significant spending growth ($120 billion, or 13 percent) since 2008, the year before the president came into office. At the president's request for 2013, the Department of Education would receive 21 percent more than in 2008, including significant increases in K-12 spending (the Race to the Top and Science Technology, Engineering, and Mathematics programs are big winners) and higher education, including Pell Grants. The Department of Justice would be nearly 20 percent higher in 2013 than in 2008, and the Department of Commerce would be 17 percent above the 2008 level.

Increase in Proposed 2013 Discretionary Appropriations over 2008 Levels by Agency

(Budget authority, by fiscal year, in billions of nominal dollars)

	2008	2013	Change from 2008	
	Actual	**Request**	**Dollars**	**Percent**
Discretionary Funding by Agency (Excludes War and Emergency Funding):				
Security Agencies[1]				
Defense--Military Programs	479.2	525.4	46.2	10%
Energy - National Nuclear Security Administration	9.1	11.5	2.5	27%
Homeland Security	34.9	39.5	4.6	13%
Veterans Affairs	39.4	61.0	21.6	55%
Intelligence Community Management Account	0.7	0.5	-0.1	-21%
State and Other International Programs[2]	34.3	48.0	13.7	40%
Subtotal, Security Agencies	**597.6**	**686.0**	**88.4**	**15%**
Non-Security Agencies[1]				
Agriculture	20.0	22.3	2.3	11%
Commerce	6.9	8.1	1.2	17%
Education	58.0	69.9	11.9	21%
Energy (excluding National Nuclear Security Administration)	15.1	15.9	0.8	6%
Health and Human Services	73.1	78.4	5.3	7%
Housing and Urban Development	37.7	35.3	-2.3	-6%
Interior	11.2	11.6	0.4	4%
Justice	22.6	26.7	4.1	18%
Labor	11.3	12.0	0.7	6%
Transportation	15.4	13.8	-1.7	-11%
Treasury	12.0	13.4	1.4	12%
Corps of Engineers	5.6	4.7	-0.9	-16%
Environmental Protection Agency	7.6	8.3	0.8	10%
National Aeronautics and Space Administration	17.1	17.7	0.6	3%
National Science Foundation	6.0	7.4	1.3	22%
Small Business Administration	0.6	0.9	0.4	67%
Social Security Administration	8.2	9.0	0.9	11%
Corporation for National and Community Service	0.9	1.1	0.2	22%
Other Agencies[3]	13.7	18.3	4.6	34%
Subtotal, Non-Security Discretionary Budget Authority	**343.0**	**374.9**	**31.9**	**9%**
Total, Discretionary Budget Authority (ex. War and Emergency)	**940.6**	**1,060.9**	**120.3**	**13%**

2008 Data reflects CBO scoring at time of enactment, excluding Changes in Mandatory Programs (ChiMPs). As such, the figures do not account for the effects of inflation between fiscal years 2008 and 2013.

1 Under the original BCA cap regime (pre-fallback sequester), the security category consists of appropriations for the Departments of Defense, Homeland Security, and Veterans Affairs; the National Nuclear Security Administration; the intelligence community management account; and all accounts in function 150 (international affairs). All other appropriations are considered non-security.

2 Budget Function 150. Figures exclude war funding for function 150 programs. In the 2013 Request, that amount is $8.2 billion; in 2008, that amount was $2.4 billion.

3 Includes across-the-board reductions that have not been distributed by agency.

National Defense The budget proposes to fund the Department of Defense at $525.4 billion for 2013, a decrease of $5.1 billion from last year. Compared to the president's 2012 budget request, the president is now proposing to spend $487 billion less over the 2012-2021 period in order to remain within the statutory caps on spending enacted in the BCA.

The president's request does not reflect the potential $500 billion in defense cuts from automatic enforcement procedures (fallback sequester) required under the BCA as a result of the failure of the Joint Select Committee on Deficit Reduction. Instead, the budget proposes to "turn off" that sequester (replacing it with tax increases) and to revise the 2013 security and non-security caps back to their initial BCA levels and to one overall cap for 2014-2021.

The budget proposes $96.7 billion for Overseas Contingency Operations (OCO) in 2013, a decrease of nearly $30 billion from 2012. This request includes $88.5 billion for activities under the Department of Defense and $8.2 billion for the Department of State and other international programs. Of the OCO funding for State and USAID, $3.3 billion is for Afghanistan, $1 billion is for Pakistan, and $4 billion is for Iraq.

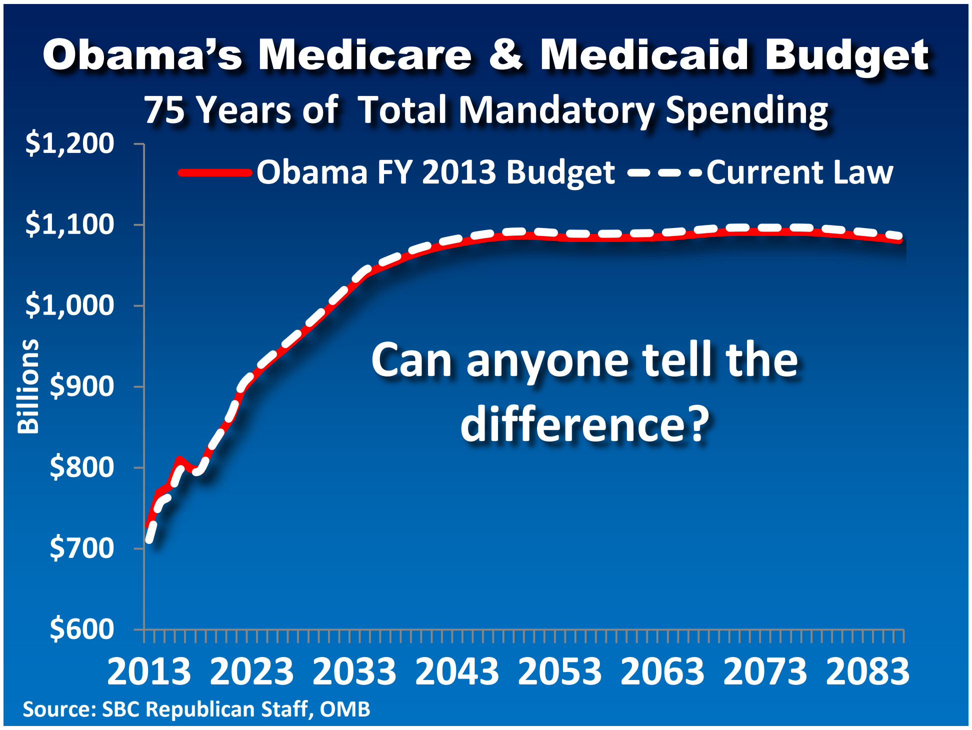
After 2013, the budget includes an annual placeholder of $44.2 billion for 2014-2021, reflecting the president's proposal to cap OCO budget authority at $450 billion over the 2013-2021 period. The administration is claiming nearly $850 billion in "savings" from the implementation of these caps over the 2013-2022 period, despite the fact that OCO funding was already on its way down and the amounts provided in the baseline were never expected to be spent. The use of caps on OCO spending to provide offsets or claim deficit reduction is widely acknowledged as a budget gimmick.[5]

Health Care The mandatory health care components of the president's 2013 budget submission are nearly identical to his proposal to the Joint Select Committee on Deficit Reduction last September. Predictably, the president does not propose repealing, defunding, or delaying any of the major programs in his health care law.

The president claims that the health care proposals in his budget will result in gross spending reductions of $366 billion over the next decade (2013-2022), including roughly $303 billion in Medicare savings, $56 billion in Medicaid savings and $8 billion in other health-care related savings. However, the president's budget would continue to freeze Medicare payments to physicians over the next 10½ years (rather than letting them fall at the end of this month by nearly one-third as scheduled under current law), which will cost $438 billion. On net, therefore, spending on mandatory health programs will **increase** by $72 billion under all the policies reflected in the president's budget.

Under the president's proposals, Medicare and Medicaid spending will total $11.1 trillion over the next decade. While the president's proposals result in modest savings relative to current law near the end of the decade, they will increase spending on net over the ten-year period. However, the president's proposals will not significantly alter the course of long-term spending for these programs.

[5] For more information about this gimmick, please click here to see a Budget Committee Republican background document.



Senate Budget Committee minority staff estimates that under current law total mandatory spending for Medicare and Medicaid will exceed $76.3 trillion over the next 75 years. In the long term, the president's proposals would only reduce that amount to $76.1 trillion, **a reduction of less than one half of one percent**. The president admitted in the introduction to his budget that health care is "the major driver of future deficit growth," but his plan fails to address that single biggest driver of our long-term fiscal problems.

Medicare The president's budget increases Medicare spending by $135 billion over 2012-2022, despite including the following proposals (numbers in [brackets] are savings [-] or costs [+] estimated by OMB over the 2013-2022 period):

- Force pharmaceutical manufacturers to pay Medicaid-level rebates to Medicare for low-income beneficiaries [-$155 billion]
- Reduce payments to rural providers and post-acute care services [-$65 billion]
- Reduce Medicare bad debt and graduate medical education payments [-$45 billion]
- Increase income-related premiums under Medicare Parts B and D [-$28 billion]
- Prohibit drug companies from delaying the availability of generics and biologics [-$9 billion]
- Modify the Part B deductible, create a Part B premium surcharge on near-first dollar Medigap coverage, and add a home health co-pay for new beneficiaries [-$5 billion]
- Reduce the exclusivity period for follow-on biologics [-$4 billion]
- Reduce waste, fraud and abuse in Medicare [-$2 billion]
- Interactions [+$8 billion]
- Extend the Qualified Individuals (QI) program through 2015 [+2 billion]

- Further empower the Independent Payment Advisory Board (IPAB) [No savings in the budget window]

<u>Medicaid</u> Under current law, Medicaid spending is projected to total $4.4 trillion over the next 10 years, including the substantial increase in Medicaid spending required to begin in 2014 under the president's health law. The president's budget includes the following policies that he claims will reduce Medicaid spending by $56 billion over the next years (numbers in [brackets] are savings [-] or costs [+] estimated by OMB over the 2013-2022 period):

- Restrict the use of Medicaid provider taxes [-$22 billion]
- Establish a single blended matching rate to Medicaid and CHIP [-$18 billion]
- Rebase Medicaid disproportionate share hospital (DSH) payments [-$8 billion]
- Limit Medicaid reimbursement of durable medical equipment (DME) to Medicare rates [-$3 billion]
- Reduce waste, fraud and abuse in Medicaid [-$3 billion]
- Prohibit drug companies from delaying the availability of generics and biologics [-$2 billion]
- Reduce the exclusivity period for follow-on biologics [-$0.2 billion]
- Extend Transitional Medical Assistance (TMA) through 2014 [+$1 billion]
- Introduce more federal control and oversight of state Medicaid programs, add state program integrity reporting requirements, and enable states to require "benchmark" benefit plans for non-elderly, non-disabled adults above 133% FPL [No savings]

<u>Other Health Care Proposals</u> The president's other health care proposals include (numbers in [brackets] are savings [-] or costs [+] estimated by OMB over the 2013-2022 period):

- Increase TRICARE pharmacy benefit copayments and TRICARE-For-Life premiums [-$17 billion]
- Rescind resources available for the prevention and public health fund [-$4 billion]
- Enable OPM to contract directly for pharmacy benefits for Federal Employee Health Benefit (FEHBP) [-$2 billion]
- Enact Food Safety and Inspection Service (FSIS) fee [-$0.1 billion]
- Postal Service reforms [+13 billion]
- Expand small business health insurance tax credit from the president's health law [+$1 billion]
- Funding for the Secretary of Health and Human Services to implement proposals [+$0.4 billion]
- Extend Social Security Insurance (SSI) for qualified refugees [+0.2 billion]
- Increase child support payments [+$0.1 billion]
- Accelerate "State Innovation Waivers" [No savings]

Social Security Since 2011, the cost of providing retirement and disability payments to Social Security recipients has exceed the amount of tax revenue collected—a shift that required the Social Security Administration to use interest payments on the trust fund to cover the cash shortfall. But as the president's budget shows, by 2022, benefit costs will outstrip both cash and interest income to the trust fund, and the Social Security Administration (SSA) will begin redeeming its special Treasury securities to continue to pay scheduled formula benefits—an act that will require the Treasury Department to raise taxes, cut spending elsewhere, or issue additional debt.

Absent any policy changes, current law requires SSA to significantly reduce the retirement and disability benefits for future retirees once the trust funds are exhausted. For example, according to the 2011 report of the Social Security trustees, the disability trust fund will be exhausted in just 6 years, resulting in lower disability benefit payments. Despite this near-term danger, the president's budget fails to include any proposals to strengthen Social Security for retirees or for the disabled.

Education The budget requests $69.8 billion for discretionary programs in the Department of Education for 2013, which is a $2.4 billion increase over the 2012 funding level of $67.4 billion.

The president would increase the maximum award for Pell Grants to $5,635, up from $5,550 in 2012. This maximum award is made up of $4,860 from the discretionary award and $775 from the mandatory add-on ($85 more than the mandatory component of $690 in 2012). To fund these award levels, the budget includes $36.1 billion, of which $22.8 billion is discretionary. In order to sustain this level of Pell Grants in future years, the Administration proposes increasing mandatory spending by $14 billion to reduce the burden on the discretionary spending cap and make room for other discretionary spending. This continues the recent practice of using new funding streams in the place of substantial reforms for a program that has doubled in cost since 2008.

The president also proposes new mandatory grant programs over the budget window. These include: $4 billion for a community college initiative (matched by another $4 billion in the Department of Labor), $5 billion for a competitive grant program for states and districts to work with teachers and unions to recruit new teachers, $1 billion to establish career academies, and $500 million to overhaul TEACH grants and replace them with Presidential Teaching Fellows.

Regarding student loan programs, the budget proposes to prevent the interest rate on subsidized Stafford Loans from reverting this summer to the previous fixed rate of 6.8 percent for the 2012–2013 academic year and beyond, as required by current law. Over the past four years, the interest rate on this subset of loans has been temporarily declining to 3.4 percent for this 2011–2012 academic year, with an increase to 6.8 percent set to kick in as a result of the College Cost Reduction and Access Act, enacted by Democratic-controlled Congress in 2007. This proposal to maintain the interest rate at 3.4 percent for one more year will cost $5.7 billion over the 2012-2022 period.

The president also renews his proposal to reform and expand the Perkins loan program, claiming savings of nearly $9 billion over the budget window. For this proposal, the Administration relies on faulty credit reform scoring to show that lending to students makes the federal government a profit. For a similar proposal last year, the Congressional Budget Office found that using a more realistic fair-value estimate of the proposal, which captures market-risk, shows a multi-billion dollar cost to taxpayers.[6]

Transportation Trust Fund (TTF) Despite $35 billion in transfers from the General Fund of the Treasury over the past four years, the Highway Trust Fund (HTF) will become insolvent at some point in 2013. The president's budget does not address this issue; rather, its most transformative proposal appears to be to simply rename the HTF as the Transportation Trust Fund. Then, without changing the stream of trust fund revenues, it would increase the burdens on the trust fund by expanding the number of highway safety, transit, and passenger rail programs to be paid for by the TTF.

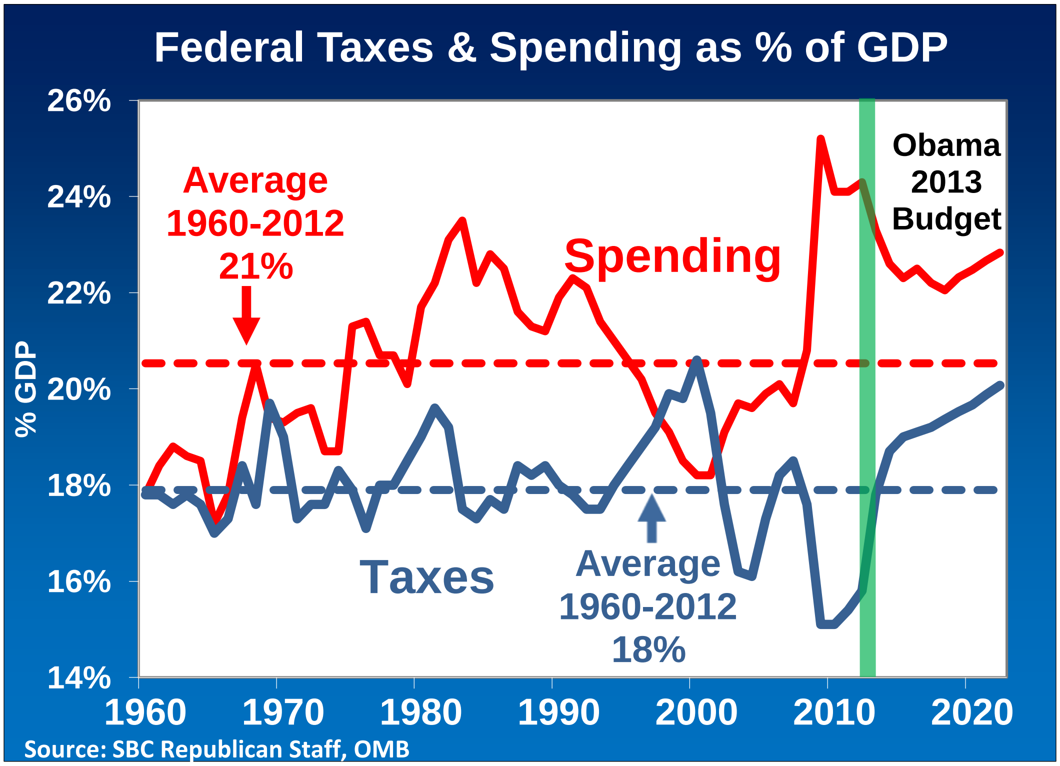
Just over the 2013-2018 period of its reauthorization proposal, the Administration would set spending authority at $231 billion more than the expected revenues, which will require a transfer from the General Fund to prevent the fund from becoming insolvent. (The budget claims it is using some "savings" from spending less money on the war for transportation spending, but this is a meaningless statement. This offset is an accounting trick because it claims artificial savings from money that would never be spent in the first place.) This is the opposite of the proposal in the 2012 request where the president swore off any permanent transfers from the General Fund ("the Administration's proposal does not require any future General Fund transfers..."; see page 153 of last year's *Analytical Perspectives*).

The Administration's proposal also stands in stark contrast to the bills currently being debated on the House and Senate floors, which increase spending only slightly and do not create future unsustainable burdens on the HTF with new programs. The proposal would reclassify all outlays associated with these programs as mandatory and subject to the PAYGO law (thereby eliminating one byzantine feature of the current program that makes it impossible for most people to understand how it operates). Separate from the trust fund, the budget proposes a mandatory appropriation of $50 billion in 2012 for a transportation stimulus program.

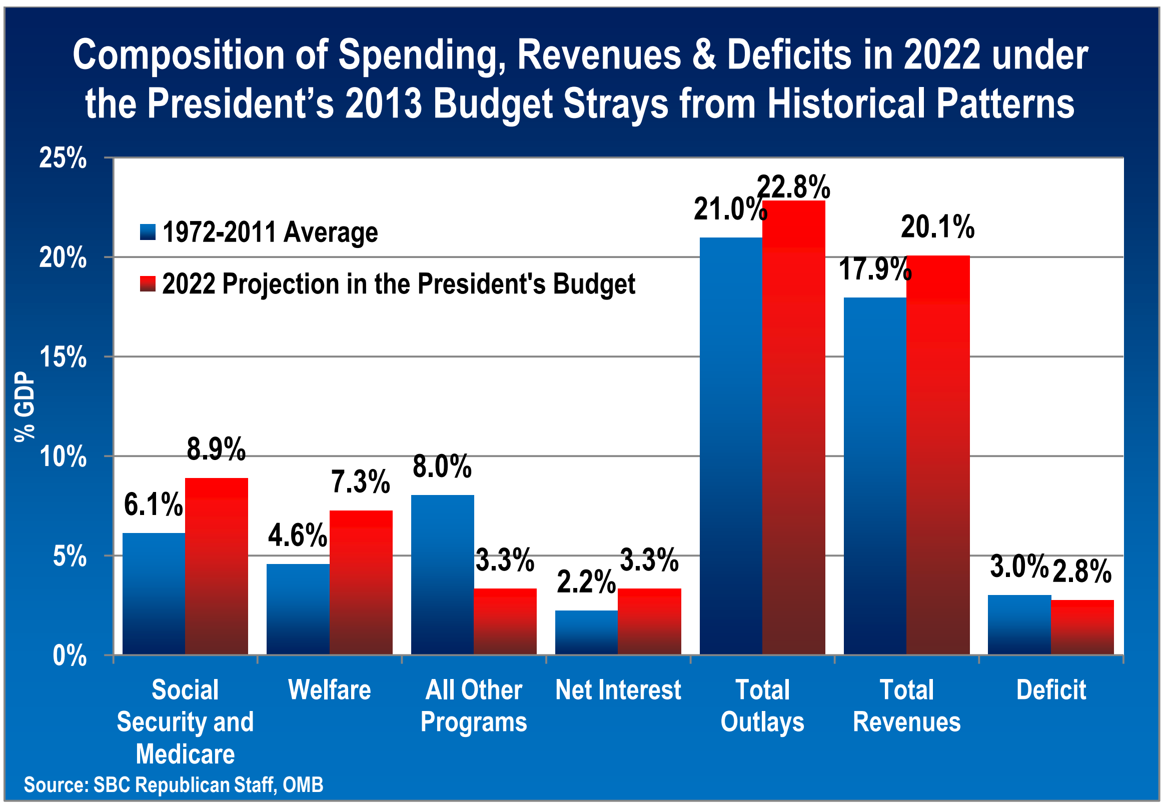
[6] Ranking Member Sessions has introduced legislation that would, among other things, require CBO to use a more realistic accounting method when scoring lending proposals.

Spending And Revenues As Fraction Of GDP

Given all these changes, the president's budget does not put the federal government's fiscal policy on a course that is much different than where it is already and where it is headed. Under the president's proposals for 2013, spending will be 23 percent of GDP and revenues will be 18 percent. If the president's policies are enacted and sustained for 10 years, the president estimates spending in 2022 will be 23 percent of GDP and revenues will be 20 percent. Clearly, all the change is on the tax side of the budget. The following graph illustrates this path.



Another way to indicate what is driving the unsustainable trends under the president's proposals is to look at components of spending, total spending, revenues, and deficits (as a percentage of the economy) that the Administration estimates will occur in 2022 and compare that to the average for those elements over the last 40 years (1972-2011). From the graph below, it is clear that Social Security and Medicare, which will consume 8.9 percent of GDP in 2022, are taking more resources out of the economy than the 6.1 percent they have on average for the past 40 years. Welfare programs demonstrate a similar 2.7 percentage point increase in 2022. Interest costs will be higher because the debt will be so much larger in 2022 than it has been in the past, with all other spending programs getting squeezed out. In total, outlays will be 1.8 percentage points higher in 2022 than the 40-year average, and revenues will be 2.2 percentage points higher. Clearly, tax increases in the president's budget contrast against a permanent 10 percent expansion in the size of the federal government (as a share of the economy).



Budget Process Reform Proposals And Performance Initiatives

Repeal the Fallback Sequester and Revise the BCA Discretionary Caps As discussed previously in this summary, the president proposes to repeal the $1.2 trillion sequester of spending that OMB is required by the BCA to implement in January 2013 (and each year thereafter over the 2014-2021 period). His budget claims it proposes sufficient replacement savings from tax increases to warrant turning off the sequester. Related to this proposal, the president wants to revise the discretionary caps so that the security category in 2013 encompasses about two-thirds of the discretionary budget rather than half (the National Defense budget function 050) as it stands currently. For 2014-2021, the president proposes to revert to one total discretionary cap rather than the two categories of caps (defense and non-defense) that currently apply.

Expedited Rescission The Administration proposes a special process for the president to submit rescissions of discretionary and non-entitlement mandatory spending for fast-track consideration. The rescissions would first be considered in the House, which would be required to vote on the package without amendment within a specified number of days. If the package passes the House, then the Senate would consider the same package, without amendment, within a specified number of days. The House has already passed a similar proposal (H.R. 3521, The Expedited Legislative Line-Item Veto and Rescissions Act) on February 8, 2012.

Limit on Advance Appropriations Although for the last decade or so the congressional budget resolution has set a limit on advanced appropriations, the Administration proposes that the advanced appropriations limit for 2014 should be $28.858 billion (which is higher than the limit of $28.821 billion proposed in the 2012 budget) and should remain at that level for subsequent years.

Debt Trigger The president includes the debt trigger proposal he originally submitted to the Joint Super Committee in September 2011. The proposal sets a target for federal debt (measured as debt held by the public, net of financial assets). If debt strays above the targets, then failure by Congress to enact sufficient savings to bring debt back down to the target would result in OMB implementing automatic reductions in spending and tax expenditures.

Expand the Race to the Top Model The president proposes to take the Race to the Top model used in education and replicate it in transportation, workforce training, and advanced vehicle development programs. Race to the Top is a competitive grant program to incentivize states to pursue educational reforms aimed at achieving certain goals.

Economic Assumptions

The Obama Administration's near-term assumptions about growth in real (inflation-adjusted) gross domestic product (GDP) are significantly rosier than forecasts in the CBO's January, 2012 *Budget and Economic Outlook* and those contained in the *Blue Chip Economic Indicators* (which averages around 50 private forecasts). The Administration projects GDP growth that is higher than CBO's forecast by one-half of a percentage point in 2012 and by two percentage points in 2013. Some of this difference is attributable to different assumptions about the future path of fiscal policy. OMB assumes that all of the president's budget proposals will be enacted, while CBO assumes that the 2001 and 2003 tax cuts all expire and the sequester goes into effect. Private forecasters' assumptions about near-term fiscal policy fall somewhere between the two.

The Administration's near-term assumptions about inflation are similar to CBO and Blue Chip forecasts. All see a continuation of low inflation, with growth in the consumer price index for urban consumers (CPI-U) projected to remain around 2.0 percent through 2013, with an eventual edging up above 2.0 percent in the longer term. The Administration sees inflation edging up to 2.1 percent by 2016 and thereafter, while CBO projects a mild acceleration of inflation from 2014 to 2018, where inflation stabilizes at 2.3 percent.

The Administration's near-term forecast for the civilian unemployment rate is more optimistic than CBO but not quite as low as Blue Chip. The Administration expects the unemployment rate to be 8.9 percent in 2012, subsiding slightly to 8.6 percent in 2013 and edging down further to 8.1 percent in 2014. Note that all forecasters expect unemployment to remain stubbornly high for years to come. The Administration does not expect the unemployment rate to fall below 7.0 percent until 2016, suggesting its policies will not quickly reduce the plight of the unsatisfactorily large number of unemployed Americans.

The table below compares the Administration's near-term economic assumptions with the latest "Long-Range Consensus U.S. Economic Productions" (from the October, 2010 *Blue Chip Economic Indicators*[7]) and CBO's January, 2012 *Budget and Economic Outlook*.

Real GDP growth CY2012		**Real GDP growth CY2013**		**Real GDP growth CY2014**	
Obama:	+2.7%	Obama:	+3.0%	Obama:	+3.6%
Blue Chip:	+2.2%	Blue Chip:	+2.6%	Blue Chip:	+2.9%
CBO:	+2.2%	CBO:	+1.0%	CBO:	+3.6%

Inflation (CPI-U) CY2012		**Inflation (CPI-U) CY2013**		**Inflation (CPI-U) CY2014**	
Obama:	+2.2%	Obama:	+1.9%	Obama:	+2.0%
Blue Chip:	+2.1%	Blue Chip:	+2.1%	Blue Chip:	+2.4%
CBO:	+1.7%	CBO:	+1.5%	CBO:	+1.5%

Unemployment rate CY2012		**Unemployment rate CY2013**		**Unemployment rate CY2014**	
Obama:	8.9%	Obama:	8.6%	Obama:	8.1%
Blue Chip:	8.7%	Blue Chip:	8.3%	Blue Chip:	7.7%
CBO:	8.8%	CBO:	9.1%	CBO:	8.7%

[7] Blue Chip long-range forecasts are published semi-annually in the March and October issues of *Blue Chip Economic Indicators.*