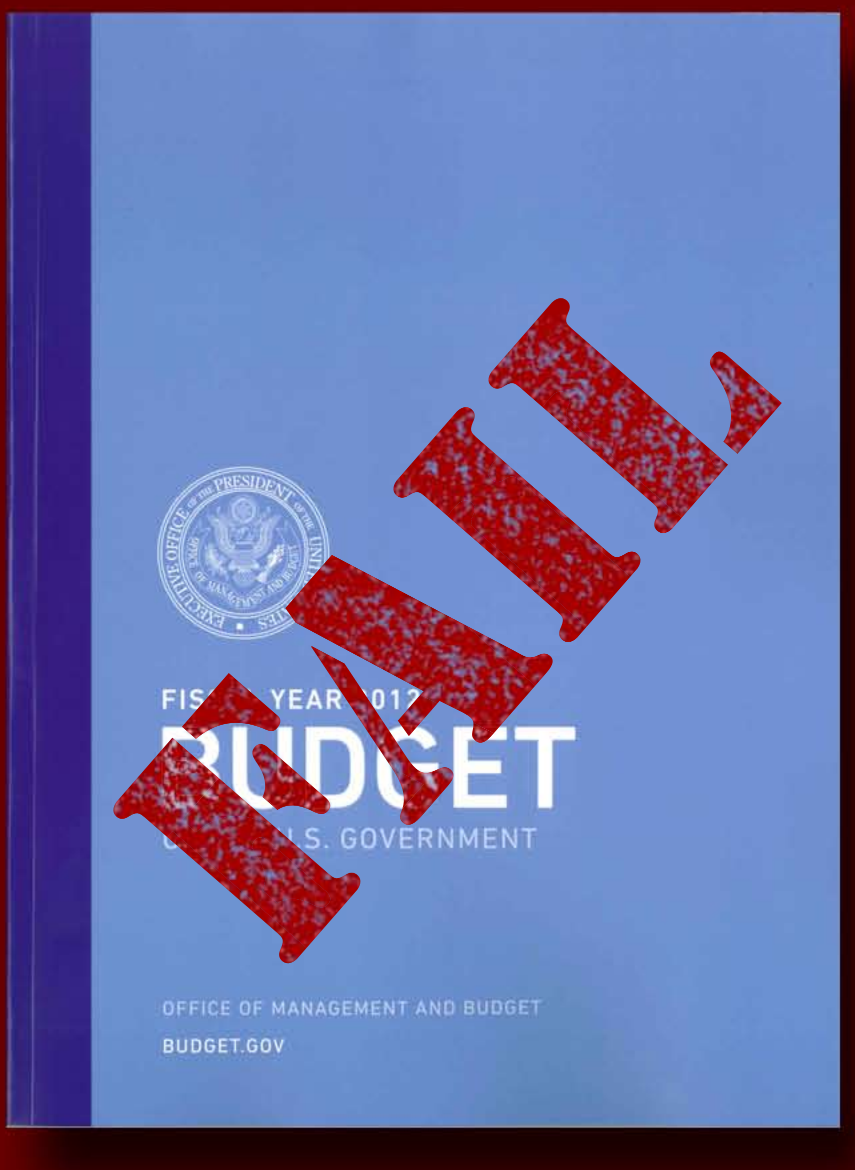
UNITED STATES SENATE

COMMITTEE ON THE BUDGET

The Obama 2012 Budget:

A Summary and Analysis



Prepared by the Senate Budget Committee Republican Staff

February 14, 2011

The Obama 2012 Budget: A Summary and Analysis

The President's budget claims it will result in declining deficits from **$1.6 trillion in 2011** (10.9 percent of GDP) to **$1.1 trillion in 2012** (7 percent of GDP) to **no less than $600 billion in any subsequent year**, averaging 3.7 percent of GDP from 2012 on.

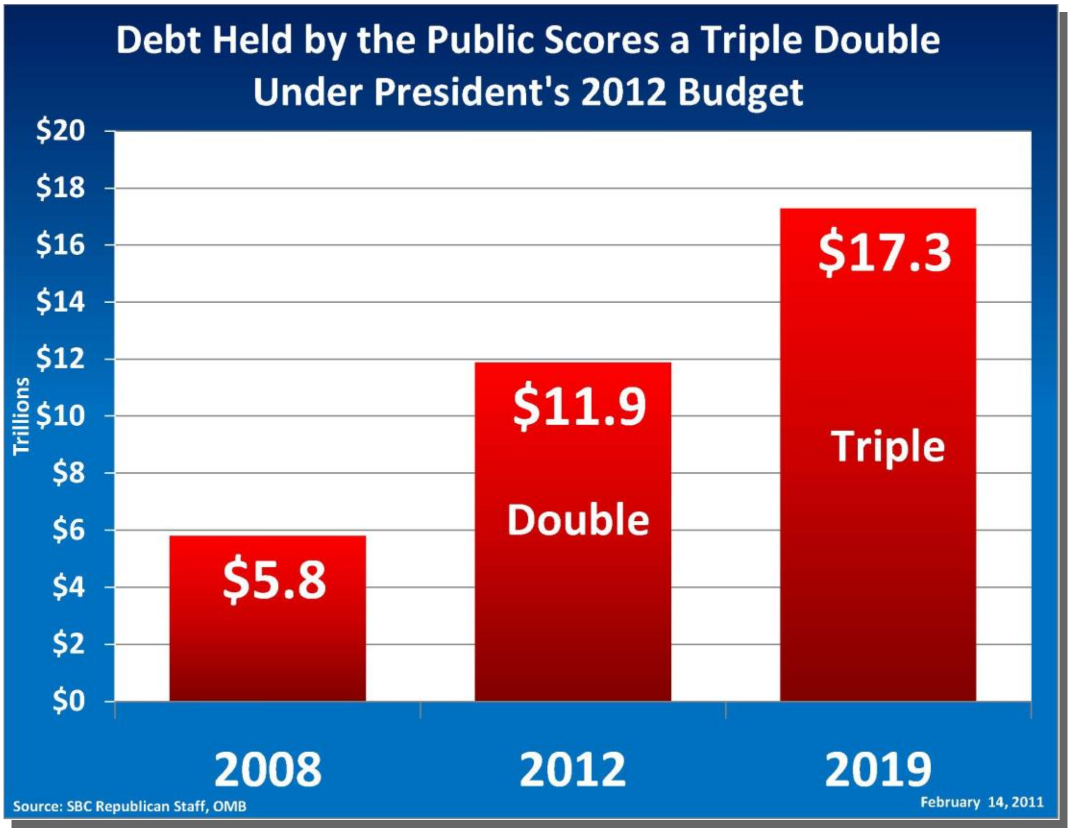
President's 2012 Budget Proposal

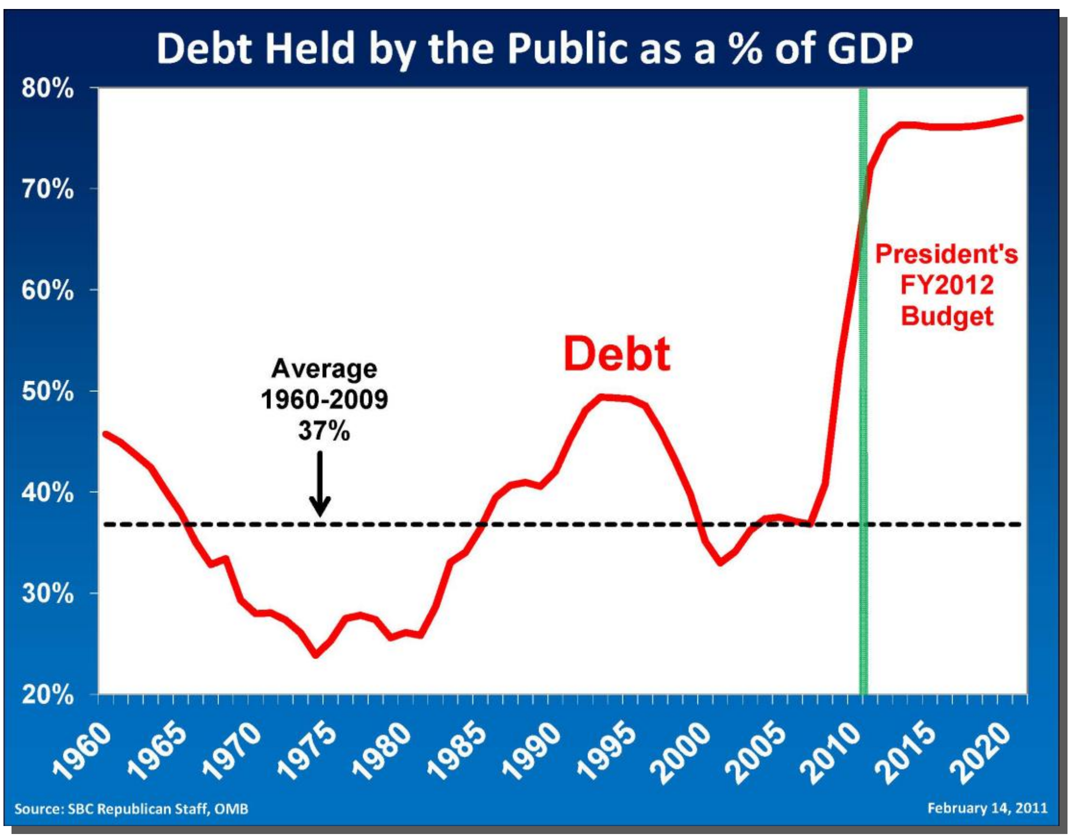
Deficits and Debt According to the President's Estimates

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Deficits														
$ trillions	0.5	1.4	1.3	1.6	1.1	0.8	0.6	0.6	0.6	0.6	0.6	0.7	0.7	0.8
% GDP	3.2%	9.9%	8.9%	10.9%	7.0%	4.6%	3.6%	**3.2%**	3.3%	3.0%	2.9%	3.0%	3.1%	3.1%
								fail!						
Debt (held by public)														
%GDP	41%	53%	62%	72%	75%	76%	76%	76%	76%	76%	76%	76%	77%	77%
$ trillions	**5.8**	7.5	9.0	10.9	**11.9**	12.8	13.6	14.3	15.1	15.8	16.5	**17.3**	18.1	19.0
					doubles							**triples**		

The budget **fails the test the President set** when he created his Fiscal Commission a year ago – to reduce the deficit so that it is no higher than 3 percent of GDP in 2015 (or a budget that is in primary balance; see pages 3-4 for discussion).

Using the figures in the President's 2012 budget document, **the budget does nothing to change the unsustainable growth of debt** held by the public as proposed in his budget nearly a year ago. Under this package of Presidential proposals, debt held by the public will more than double from $5.8 trillion (41 percent of GDP) in 2008 to $11.9 trillion in 2012. By 2019, debt under the President's policies will triple from the 2008 level to $17.3 trillion (76 percent of GDP). The graphs on the next page illustrate the growth of job-stifling debt and how it continues to rise under the President's proposals.


Debt Held by the Public Scores a Triple Double
Under President's 2012 Budget
$20
$18
$16
$14
$12
$10
$8
$6
$4
$2
$0
Trillions
$5.8
$11.9
Double
$17.3
Triple
2008
2012
2019
Source: SBC Republican Staff, OMB
February 14, 2011


Debt Held by the Public as a % of GDP
80%
70%
60%
50%
40%
30%
20%
Average
1960-2009
37%
Debt
President's
FY2012
Budget
1960
1965
1970
1975
1980
1985
1990
1995
2000
2005
2010
2015
2020
Source: SBC Republican Staff, OMB
February 14, 2011

THE PRESIDENT WASTES AN OPPORTUNITY – ANOTHER YEAR OF FAILED LEADERSHIP

Early last year, President Obama came under intense pressure from his own party to put forward a plan to reduce the deficit to about 3 percent of GDP (i.e., that the budget is in "primary" balance – that is, a balanced budget except for interest costs. All these terms were used interchangeably by the Administration) by 2015 and stabilize the debt over the long term. In his State of the Union address in January 2010, the President said:

> "I've called for a bipartisan fiscal commission, modeled on a proposal by Republican Judd Gregg and Democrat Kent Conrad. This can't be one of those Washington gimmicks that lets us pretend we solved a problem. The commission will have to provide a specific set of solutions by a certain deadline."

The President's FY 2011 budget totals – labeled "Budget (Without Fiscal Commission)" -- did not include policies to reach those goals (his projected deficit for 2015 was 3.9 percent of GDP); instead, that budget included a disclaimer in a Fiscal Commission box (see below) that postponed tough budget choices until a bipartisan Fiscal Commission did the work.

Table S–1. Budget Totals
(In billions of dollars)

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Totals 2011-2015	Totals 2011-2020
Budget (Without Fiscal Commission)														
Budget Totals in Billions of Dollars:														
Receipts	2,105	2,165	2,567	2,926	3,188	3,455	3,634	3,887	4,094	4,299	4,507	4,710	15,771	37,268
Outlays	3,518	3,721	3,834	3,755	3,915	4,161	4,386	4,665	4,872	5,084	5,415	5,713	20,051	45,800
Deficit	1,413	1,556	1,267	828	727	706	752	778	778	785	908	1,003	4,280	8,532

FISCAL COMMISSION

The Administration supports the creation of a Fiscal Commission. The Fiscal Commission is charged with identifying policies to improve the fiscal situation in the medium term and to achieve fiscal sustainability over the long run. Specifically, the Commission is charged with balancing the budget excluding interest payments on the debt by 2015. The result is projected to stabilize the debt-to-GDP ratio at an acceptable level once the economy recovers. The magnitude and timing of the policy measures necessary to achieve this goal are subject to considerable uncertainty and will depend on the evolution of the economy. In addition, the Commission will examine policies to meaningfully improve the long-run fiscal outlook, including changes to address the growth of entitlement spending and the gap between the projected revenues and expenditures of the Federal Government.

Excerpt from Table S-1, *Budget of the U.S. Government Fiscal Year 2011*, Office of Management and Budget

In September 2010, the President's nominee for OMB Director restated the goal that the President had set for his Fiscal Commission:

> "The Administration has set a goal of putting the budget in primary balance by 2015. This would stabilize the debt-to-GDP ratio at an acceptable level by the middle of the decade, which is a key measure of fiscal sustainability."
>
> Jack Lew, written response to question from Sen. Conrad, September 7, 2010

In early December 2010, the Fiscal Commission produced a budget plan that reduced the deficit to $421 billion (2.3 percent of GDP) in 2015 and the debt to 40 percent of GDP by 2035, far exceeding the goals set by the President. Eleven of the 18 Commission members (more than 60 percent) supported the plan, including five of the six members appointed by the President.

Commission Plan *(Billions of dollars)*	2010	2011	2012	2013	2014	**2015**	2016	2017	2018	2019	2020	2011-2015	2011-2020
Revenues													
Total	2,143	2,511	2,722	3,045	3,387	**3,603**	3,844	4,077	4,303	4,541	4,774	15,268	36,806
Outlays													
Social Security	701	726	752	786	826	**870**	921	975	1,035	1,100	1,167	3,960	9,159
Health Care	738	799	795	828	917	**1,013**	1,133	1,208	1,261	1,367	1,461	4,353	10,782
Other Mandatory	487	573	475	441	433	**429**	449	443	435	456	463	2,351	4,596
Discretionary	1,358	1,379	1,385	1,297	1,237	**1,200**	1,195	1,195	1,197	1,210	1,222	6,498	12,518
Net interest	202	226	264	338	429	**511**	579	628	670	705	739	1,768	5,089
Total	3,485	3,703	3,671	3,691	3,842	**4,024**	4,276	4,450	4,597	4,839	5,052	18,930	42,144
Deficit (-) or Surplus	-1,342	-1,192	-949	-646	-455	**-421**	-432	-372	-294	-298	-279	-3,663	-5,338
Debt Held by the Public	9,031	10,133	11,200	11,952	12,497	**13,004**	13,522	13,987	14,380	14,779	15,164	n.a.	n.a.

Excerpt from Figure 16, *The Moment of Truth*, The National Commission on Fiscal Responsibility and Reform

The President, in a statement issued on December 3, 2010, acknowledged the work of the Commission and led us to think that his *next* budget would be different:

> "The Commission's majority report includes a number of specific proposals that I – along with my economic team -- will study closely in the coming weeks as we develop our budget and our priorities for the coming year."

The President's 2012 budget disappoints once again. After raising expectations, the President falls far short, as the truth can be found by looking at the levels of the deficit and debt in his budget. Under the President's estimates, the deficit is $607 billion in 2015, while interest payments on the debt that year are $494 billion, so his budget does not achieve his goal of primary balance. (If the 2012 budget had achieved primary balance in 2015, then the unified deficit would have been $494 billion – the same as the interest costs. But instead, his projected deficit is more than $100 billion higher than the goal.) To make matters worse, the President's deficit rises to $735 billion in 2020, rather than continuing to fall as under the Fiscal Commission's plan. And the debt rises steadily from 62 percent of GDP in 2010 to 77 percent of GDP by 2021, so his budget never achieves his goal of stabilizing the debt.

Table S-1. Budget Totals
(In billions of dollars)

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	Totals 2012-2016	Totals 2012-2021
Budget Totals in Billions of Dollars:														
Receipts	2,163	2,174	2,627	3,003	3,333	3,583	3,819	4,042	4,257	4,473	4,686	4,923	16,366	38,747
Outlays	3,456	3,819	3,729	3,771	3,977	4,190	4,468	4,669	4,876	5,154	5,422	5,697	20,134	45,952
Deficit	1,293	1,645	1,101	768	645	607	649	627	619	681	735	774	3,769	7,205

Excerpt from Table S-1, *Budget of the U.S. Government Fiscal Year 2012*, Office of Management and Budget

REALITY CHECK

Comparison to CBO

Some media coverage may suggest the President's budget is being honest or "realistic" about the deficits associated with his policy proposals because he estimates his deficits will be higher than the CBO estimates of baseline deficits released last month over 2012-2021. But that is a false comparison.

CBO's baseline estimates simply project what the deficit would look like if Congress sat on its hands and enacted **no changes** to current law for the next 10 years. If that unlikely scenario played out, tax rates would rise in 2013 when the tax cuts are scheduled to expire under current law, and revenues would increase, resulting in lower deficits (all else equal).

The President's budget is the **opposite** of that "no new laws" scenario of the CBO baseline. Instead, the figures associated with the President's budget reflect the Administration's estimates of the deficits and debt that would result if **ALL the policies in the President's budget** were enacted and remained in place for the next 10 years.

In truth, the deficits resulting from the President's budget are a lot higher than they appear compared to the CBO baseline because, even before he does the "hard work" of making his deficit-increasing policy proposals, the President awards himself with a 4-percent "bonus" in his baseline. Specifically, the President assumes that revenues will be $1.7 trillion higher under current law than CBO estimates. This means that, everything else equal, the President understates the deficits associated with his 2012 budget by nearly $0.2 trillion annually compared to the estimate CBO will produce a month from now. Experience with previous budgets from this Administration suggest that deficits will not be as low as even the too-high levels claimed in this 2012 request.

- In his first budget request (for FY 2010) two years ago, the President claimed that his budget would produce deficits averaging $710 billion per year over 10 years. CBO, however, re-estimated the President's budget as producing annual average deficits ($910 billion) that were 28 percent larger than promised by the Administration because CBO did not use rosy economic assumptions and estimated lower savings for some of the Administration's proposals.

- Last year the Administration claimed its 2011 budget would result in deficits averaging $850 billion per year, but CBO's more realistic analysis pegged the President's deficits at nearly $1 trillion per year.

- When CBO completes its analysis of the President's 2012 budget next month, it is almost certain to reflect significantly <u>higher</u> annual deficits than the Administration claims in its budget today.

- There are at least two places where the budget assumes savings of more than $0.3 trillion at a pop, amounting to more than $600 billion of budget pixie dust (aka magic asterisk) that CBO may estimate as saving nothing. The Administration won't say what it wants to do – instead, its budget is full of placeholders that assume we will all come together to find agreement on difficult policies:

  ✓ $435 billion ($328 billion after the income tax offset is applied) in unspecified revenue for surface transportation programs (the "it's not a gas tax" tax).

  ✓ $315 billion for paying for the SGR doc fix after 2013 (which is magically supposed to appear from programs other than Medicare).

<u>Comparison to Fiscal Commission</u>

The President says his budget has more than $1 trillion in deficit reduction over 10 years and puts the nation on a path toward fiscal responsibility.

The Fiscal Commission found that to achieve the long-run fiscal stability that the President set as a Commission goal, it had to produce a plan that reduced the deficit by <u>$4 trillion</u> over 10 years. How can the President claim he achieves long-run fiscal stability with only <u>$1 trillion</u> in deficit reduction?

He makes the job easier by moving the starting line. The President's rosy assumptions produce $1.7 trillion in additional revenue over the next 10 years, without any change to policy.

He claims his budget includes spending cuts, but this claim needs to be put into context. First, his five-year freeze includes only 34 percent of all appropriated spending, and only 9 percent of total government spending. His "freeze" ***adds*** spending above the levels recommended by the Fiscal Commission. Under the "freeze" rubric, his OMB Director claims he has tough discretionary cuts that will poise the nation to invest in the future. But what does "invest in the future" mean to this President? He's said it himself – it means more spending.

He says his budget cuts mandatory spending, but it does not. If you reduce spending in one place and increase it by more in another, it is not a spending cut; the government continues to grow. The numbers don't lie. The President's 2012 budget increases mandatory spending by $404 billion over the next 10 years.

The President says his budget takes a $300 billion bite out of tax expenditures, the biggest reduction in 25 years. What he fails to tell you is that his budget expands existing tax expenditures by nearly $400 billion over 10 years. Net result = more tax expenditures.

This Administration's own talking points reveal the President's lack of leadership. Over the next few weeks, the President and his cabinet will sell his budget by saying:

- "It puts the nation on a path toward fiscal sustainability where the government will no longer be adding to its debts."
- "These are down payments on long-term reform."
- "This is a critical first step. It's a down payment on what we need to do to tackle the long-term fiscal challenges we face."

This nation does not need a "down payment" or a "primrose path." It needs leadership.

Revenues

OMB "bonus" baseline revenues from rosy assumptions As a result of more optimistic assumptions about near-term economic growth, the Administration projects $1.7 trillion in additional revenue collections compared with CBO's baseline. Forty-four percent of this amount is attributable to higher individual income taxes, 30 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 are taxed at a higher effective tax rate -- 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 imposes $1.6 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. It also assumes that the estate tax rate increases to 45 percent and the exemption amount falls to $3.5 million. The exemption amount would not be indexed for inflation. Together, both provisions would increase revenues by $807 billion over the next ten years.

The budget includes a proposal, entitled "Bipartisan financing for Transportation Trust Fund," that would raise revenues $435 billion over ten years. That amount is offset by $107 billion of reduced collections of income and payroll taxes. (Increased excise taxes tend to depress the collection of other sources of receipts and by standard budgetary convention a 25 percent offset is assumed.) Net new collections total $328 billion. Of that amount, 73 percent would be dedicated to a combination of highway trust fund spending, aviation spending, and TIGER grants. The remaining $87 billion would be used to reduce the deficit. While no details are available, the additional amount of revenue collected from the proposal is similar to both the Carper-Voinovich $0.25 gas tax increase and CBO's 2009 deficit reduction option. In a letter to the Fiscal Commission, Senators Carper and Voinovich described their proposal as raising the gas tax by one cent per month for 25 months. Their proposal dedicated 10 cents to deficit reduction and 15 cents to fund transportation improvements. They proposed indexing the tax to inflation once it was fully phased in.

Once again this year's budget proposes a tax on the financial sector to recoup the federal government's cost of operating the Troubled Assets Relief Program, as required by the law that created that program. The "Financial Crisis Responsibility Fee," would seek to collect $30 billion over ten years. Last year's budget proposed a fee totaling $90 billion.

The President's budget includes other revenue raisers that were also proposed last year, such as $30 billion in additional revenues from efforts to reduce the tax gap and $129 billion in higher taxes from international tax enforcement and reform (despite pledging to reform the corporate tax code to make America more competitive). The President is also proposing to repeal several tax preferences for fossil fuels, raising taxes by $46 billion over ten years. He also proposes to reinstate Superfund taxes and increase the Oil Spill Liability Trust Fund one cent ($21 billion), tax carried interest as ordinary income ($15 billion), and repeal last-in-first-out accounting ($53 billion).

Unlike last year, the Administration's budget does not propose climate change legislation or any revenues associated with such legislation.

The Administration also proposes to eliminate estimated corporate timing shifts of receipts in 2014 and 2019. Although these timing shifts have no impact on the budget deficit over time, previous legislation had included them in order to evade PAY-GO budgetary enforcement rules in the House and Senate.

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 $56 billion in forgone revenue over the next ten years. Since this credit is also refundable, another $37 billion of outlays is reflected on the spending side of the budget. The Administration also proposes to reform and extend the Build America Bonds program that Congress decided to let expire at the end of last year. It would increase spending $59.704 billion and increase revenues $59.676 billion for a net deficit increase of $28 million. This policy assumes that BAB program 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 2011 enacted in December 2010.

The current 15 percent rate on capital gains and dividends expires at the end of 2012. The President's Budget assumes it continues for everyone but upper income people. Instead, he proposes that those individuals pay a 20 percent dividend and capital gains rate. Prior budgets permitted the top dividend rate to rise as high as 39.6 percent for these individuals.

The budget includes a proposal, as it did last year, to make the research and experimentation tax credit permanent. In terms of its 10-year cost, this proposal is the largest tax cut in the President's budget with a revenue cost of $106 billion. Extending certain expiring tax provisions through 2012 would have an additional cost of $22 billion over ten years. The budget also assumes $7 billion in revenue losses to promote trade.

As has been advertised several times by the President, the budget proposes to eliminate capital gains taxation on small businesses, which would cost $5 billion. In addition, the President's budget would provide an advanced energy manufacturing tax credit, extend and modify the New Markets Tax Credit, provide assistance to New York City and designate Growth Zones.

Not counting the spending associated with refundable tax credits, the gross tax relief proposed by the President amounts to $291 billion over ten years.

PRESIDENT'S TAX PROPOSALS IN 2012 BUDGET

(revenue increases (+) or decreases (-) $ billions)	2012	10-yrs 2012-21
CBO Baseline Revenue Level	**2,555**	**39,084**
OMB "bonus" baseline revenues from rosy assumptions	**89**	**1,689**
OMB Baseline Revenue Level	**2,644**	**40,773**
Tax relief included in OMB adjusted baseline[1]	**-36**	**-2,845**
OMB adj baseline	**2,609**	**37,928**
Tax increase proposals:		
Financing for Transportation Trust Fund[2]	20	328
Reduce the value of certain tax expenditures	6	321
Enforcement and reform of U.S. international tax system	8	129
Implement program integrity allocation adjustments[3]	0	56
Repeal LIFO method of accounting for inventories	--	53
Eliminate fossil fuel tax (coal, oil, and gas) preferences	4	46
Strengthen unemployment insurance system solvency[3]	-2	46
New taxes on financial institutions and products	0	33
Reduce the tax gap	1	30
Reinstate Superfund taxes, raise oil spill TF rate by one cent	1	21
Make unemployment insurance surtax permanent	1	15
Tax carried interest as ordinary income	2	15
Modify treatment of insurance companies and products	0	14
Repeal lower-of-cost-or-market inventory accounting method	--	8
Other	0	1
Subtotal, tax increase proposals	**42**	**1,117**
Tax relief for individuals:		
20% top dividend and capital gains rate	-8	-124
Extend American opportunity tax credit[4]	--	-56
Automatic enrollment in IRAs and double the tax credit for small employer plan startup costs[4]	--	-13
EITC and child and dependent care tax credit[4]	0	-7
Subtotal, tax relief for individuals	**-8**	**-200**
Tax relief for businesses and regional growth:		
Make research and experimentation tax credit permanent	-5	-106
Extend certain expiring provisions through 2012[4]	-9	-20
Promote trade	0	-7
Eliminate capital gains taxation on small businesses	--	-5
Tax credits for energy efficient commercial buildings and advanced energy manufacturing	-1	-5
Assistance to New York City	0	-2
Build America bonds, New Markets tax credit, Growth Zones[4]	0	55
Subtotal, tax relief for businesses	**-15**	**-91**
Other revenue effects	0	-6
Total, net effect of budget proposals on revenues relative to OMB adjusted baseline	*19*	*819*
President's Budget Revenues	**2,627**	**38,747**
% of GDP	16.6%	20.0%

1. Extend 2001 and 2003 provisions for middle-income taxpayers, index AMT to inflation, and extend estate tax at 2009 parameters.
2. Budget proposes to increase excise tax receipts into the Transportation Trust Fund by $435 billion over ten years. The effect on the overall level of revenues is $328 billion because of the 25% income tax offset convention.
3. Mandatory proposal with receipt effects; only the receipt effects are shown here.
4. Proposal affect outlays, only the receipt effects are shown here. New spending embedded in the President's tax proposals equals $115 billion over 10 years.

Note: President's budget allows marginal tax rates to rise for upper income taxpayers and the estate tax to rise after the current rates expire in 2012. This adds $807 billion to revenues over the next 10 years. The CBO and OMB baselines include these additional revenues.

Spending

Discretionary Spending

> *My budget freezes annual domestic spending for the next five years – even on programs I care deeply about – which will reduce the deficit by more than $400 billion over the next decade. This freeze will bring this type of spending to its lowest level as a share of the economy since Dwight Eisenhower was president.* – President Obama, Radio Address, February 12, 2011.

The questions about this claim are – should anyone believe it and should anyone care? Some context will help answer these questions.

With regard to his first budget request (for 2010) two years ago, the President said (March 4, 2009):

> *It reduces discretionary spending for non-defense programs as a share of the economy that -- by more than 10 percent over the next decade, to the lowest level in nearly half a century.* ***I want to repeat that. I want to make sure everybody catches this****, because I think sometimes the chatter on the cable stations hasn't been clear about this. My budget reduces discretionary spending for non-defense programs as a share of the economy by more than 10 percent over the next decade, and it will take it to the* ***lowest level in nearly half a century***. [emphasis added]

And then the President's OMB Director stated:

> *And the budget reduces non-defense discretionary spending – that is, the spending appropriated each year outside of defense -- to its lowest level as a share of GDP* ***since data began to be collected in 1962***. [emphasis added]

First, the claim was not true. Actual nondefense spending was just as low or even lower in 10 years between 1962 and 2008 as the level the President claimed his 2010 budget would achieve in 2019. http://budget.senate.gov/republican/analysis/2009/bb01-2009.pdf

But more importantly, what actually happened? The President's 2010 budget requested an 11.5-percent increase in spending for nondefense discretionary programs for 2010 compared to 2009. And, that same budget pretended the President was requesting only a 2.9 percent increase in the same programs for 2011 compared to 2010. But then one year later when the President submitted his 2011 budget, he asked for **even more money** (one percentage point increase more) for 2011 than he had shown for that year in his 2010 budget. **The President could not even hold to his claimed "low" levels for one year**.

And when Republicans offered amendments in the Senate that would have locked the President's "decreasing" levels of discretionary spending in place for 10 years, the Democrats refused to vote for those amendments because they did not want to be bound by them.

So that brings us back to this budget. Only two years ago, the President's budget was claiming that nondefense discretionary spending would be at "its lowest level as a share of GDP since data began to be collected in 1962," but perhaps now OMB has found new historical data allowing the Administration to make the "lowest since Dwight Eisenhower was President in the 1950s" claim?

At this rate, if the President remains in office through much of the budget window, perhaps his future budgets will promise future levels of nondefense discretionary spending that will be the lowest share of GDP since Teddy Roosevelt ("Bully!").

Despite all these claims about shrinking discretionary spending, it is actually going up in this budget. The following table summarizes the increase in discretionary spending that the President is proposing for 2012 compared to appropriations enacted for 2008 (the last appropriation bills that did not require his signature to become law):

Increase in Proposed 2012 Discretionary Appropriations from 2008 Levels by Agency

(Budget authority in billions of dollars)

	2008[1]	2012 Request	Change from 2008 Dollars	Change from 2008 Percent
Discretionary Funding by Agency (Excludes War and Emergency Funding):				
Security Agencies:				
Defense--Military Programs	479.2	553.0	73.8	15%
Energy - National Nuclear Security Administration	9.1	11.7	2.6	29%
Homeland Security	34.9	43.2	8.3	24%
Veterans Affairs	39.4	58.8	19.4	49%
State and Other International Programs[2]	34.3	52.7	18.4	54%
Subtotal, Security Agencies	**596.9**	**719.4**	122.5	21%
Non-Security Agencies:				
Agriculture	19.5	22.0	2.5	13%
Commerce	6.8	8.8	2.0	29%
Education	57.4	77.4	20.0	35%
Energy (excluding National Nuclear Security Administration)	15.1	17.8	2.7	18%
Health and Human Services	73.0	82.2	9.2	13%
Housing and Urban Development	37.7	41.7	4.0	11%
Interior	11.2	12.1	0.9	9%
Justice	21.0	20.9	-0.1	-1%
Labor	11.2	12.8	1.6	14%
Transportation	10.7	13.4	2.7	25%
Treasury	12.0	14.0	2.0	17%
Corps of Engineers	5.6	4.6	-1.0	-18%
Environmental Protection Agency	7.6	9.0	1.4	19%
National Aeronautics and Space Administration	17.1	18.7	1.6	9%
National Science Foundation	6.0	7.8	1.8	29%
Small Business Administration	0.6	1.0	0.4	76%
Social Security Administration.	8.2	10.2	2.0	25%
Corporation for National and Community Service	0.9	1.3	0.4	49%
Other Agencies[3]	14.3	21.0	6.7	47%
Subtotal, Non-Security Discretionary Budget Authority	**335.9**	**396.8**	**60.8**	**18%**
Total, Discretionary Budget Authority (ex. War & Emergency)	**932.8**	**1,242.7**	**309.9**	**33%**

1 Reflects CBO scoring at time of enactment.
2 Budget Function 150.
3 Includes across-the-board reductions in 2008 that are not able to be distributed by agency.

In total, the President proposes non-war appropriations of $1,115 billion for the current fiscal year (FY 2011), composed of $714 billion for security agencies (e.g., Defense, Homeland Security, State) and $401 billion for non-security agencies. According to the President's figures, the non-security amount for 2011 is equal to a freeze at FY 2010 levels—essentially at the level of a full-year Continuing Resolution (CR).

Since the Administration changes its definition every year of what is security and what is non-security, a more traditional way that spending changes have been measured over time is by defense and nondefense. As shown in the table below, the President's budget proposes non-defense appropriations that are 25% above 2008 levels in 2011 and 24% above 2008 levels in 2012.

Non-Emergency Appropriations
2008 Actual and 2011 and 2012 as Proposed

($ billions)

				Percent Change	
	2008	**2011**[1]	**2012**[1]	**2008-2011**	**2008-2012**
Defense	499	574	578	15%	16%
Non-Defense	434	541	538	25%	24%
Total	**933**	**1,115**	**1,116**	**20%**	**20%**

1. The President proposes to reclassify some discretionary programs to mandatory, but detailed information on the exact amount was not available.

National Defense The President proposes $578 billion in "base" discretionary budget authority for National Defense for 2012 (not including war costs, but including the atomic defense programs of the Department of Energy and miscellaneous defense programs outside the Department of Defense). This is a 5.0 percent increase over the $550 billion annualized level available under the current 2011 CR. Over the next 10 years, the Obama Administration proposes a 2.1 percent average annual increase for National Defense.

As with last year's budget, the Administration claims non-existent "savings" from reducing war costs. Last year, the Administration budgeted only $50 billion for the cost of the wars in 2012. Now the White House is asking for $118 billion for 2012 instead. Despite the fact that the war cost should be reasonably predictable based on the planned number of deployed troops, the budget pretends war costs will drop sharply to a fixed $50 billion "placeholder" number in 2013 and every year thereafter.

International Affairs For 2012, the President proposes $53 billion in "base" discretionary budget authority for international programs, which is a one-half of one percent decrease from the 2011 Continuing Resolution level. Around 55 percent of the spending in this function goes to Department of State programs; about 12 percent to U.S. Agency for International Development programs; and the balance of the funding goes to numerous boards, commissions, and independent agencies. Over the next 10 years, the Obama Administration proposes a 2.1 percent average annual increase for International Affairs.

Note that the Administration has sharply increased proposed war costs that are carried outside the regular International Affairs budget. Up from $5.4 billion in 2011, the President is requesting $8.7 billion for war costs in 2012; the overwhelming bulk of this funding is intended for Iraq, Afghanistan, and Pakistan.

Pell Grants The Budget proposes to maintain the current Pell maximum award level of $5,550, comprised of $4,860 from discretionary funding and $690 from mandatory funding, for academic year 2012-2013, at a cost of $41 billion, of which $28.6 billion is discretionary. In order to sustain that award level in future years, the Administration first pads its version of the baseline by adding $118 billion to the current-law baseline over the 2012-2021 period so that extra funding that Congress will be asked to provide will not look like increased spending compared to OMB's version. Then the President requests $44 billion in mandatory funds to deal with anticipated growth in participation the program over the next ten years.

The Administration also has a proposal to eliminate the "year-round" Pell Grant, which enabled students to collect two Pell Grants in a single year, and to simplify the federal student aid application through the use of IRS data, which will reduce improper payments in the Pell Grant program; together these proposals would save $10.2 billion over ten years.

Mandatory Spending

The President's budget proposal leaves nearly all of the new health spending law in place and continues to request funds for its implementation. With respect to the major health entitlement programs, the budget does nothing to meaningfully reduce federal health care spending and it ignores virtually all of the health care recommendations put forth by the President's own bipartisan Fiscal Commission. The President's own Fiscal Commission concluded that: "Federal health care spending represents our single largest fiscal challenge over the long-run. As baby boomers retire and overall health care costs continue to grow faster than the economy, federal health spending threatens to balloon." Unfortunately, the President's budget fails to display real leadership in tackling this health spending challenge. After two years of this Administration talking about "bending the health care cost curve," the track of that curve remains the same as it ever was.

Medicare Under the President's baseline estimates, Medicare is projected to spend $6.133 trillion over the next ten years (2012-2021). The President's budget proposes to increase Medicare spending by $329 billion over that same ten-year period.

The President proposes a two-year "doc fix" through 2013 to override the current law reductions in physician payments scheduled to occur under the sustainable growth rate formula (SGR), at a cost of $54 billion. The President recommends a series of specific health savings proposals intended to offset his two-year SGR proposal over the ten-year budget window (see table below).

Health Offsets for SGR relief through 2013

(billions, $)

	2012-2016	2012-2021
Expand CMS program integrity authority ………………………….	-9.1	-32.3
Other Medicaid proposals…………………………………………………	-2.4	-10.6
Other Medicare proposals…………………………………………………	-0.9	-6.5
Other pharmaceutical proposals …………………………………….	-4.4	-12.9
Interactions ………………………………………………………………….	-0.5	0.1
Total……………………………………………………………………………	**-17.2**	**-62.2**

NOTE: Totals may not add due to rounding

The Administration projects that the President's health offsets will save approximately $62 billion over the 2012-2021 period. However, about half of these claimed savings rely on proposals to expand program integrity initiatives in Medicare, Medicaid, and the Children's Health Insurance Program, which CBO might score very differently.

The President also proposes extending the doc fix from 2014 onward, at an additional cost of $315 billion over the 2014-2021 period. However, the budget does not identify specific savings to offset this much larger part of the cost of the SGR proposal.

In its final report, the President's Fiscal Commission recommended paying for the full cost of the doc fix with savings within the health care system. While many experts believe that the Fiscal Commission didn't go far enough to reduce the rapid growth in federal health care spending, the final commission report included more than $400 billion in health savings proposals over the 2012 to 2020 period, an order of magnitude larger than the savings the President proposes.

Health Savings Proposed

($ billions)

	2012-2020	2012-2021
Obama Fiscal Commission	-417	N/A
Obama Budget	-48	-62

Medicaid Under the President's baseline estimates, Medicaid is projected to spend $4.387 trillion over the next ten years (2012-2021). The new health spending law included the single largest expansion of Medicaid since the program's inception. These baseline projections include the impact of this massive Medicaid expansion that is scheduled to take effect in 2014. In June of 2010, CBO estimated this expansion would increase federal Medicaid spending by roughly 20 percent. The President's budget now claims to reduce Medicaid spending from this elevated baseline by only $42 billion (less than one percent) over the next ten years.

Medical Liability Reform The President's Budget proposes $250 million in new mandatory spending over the next ten years for the Department of Justice to provide grants to states to carry out medical malpractice reforms. This is in addition to $50 million (over 2011-2015) that was already authorized in the new health reform law to establish similar state medical malpractice reform grants to be administered by the Department of Health and Human Services. Unfortunately, such grants are not estimated to reduce health care spending. By contrast, the President's Fiscal Commission recommended specific changes to medical liability rules, such as imposing a new statute of limitations for malpractice claims, which would have reduced the deficit by $17 billion over the 2012–2020 period. CBO has also estimated that enacting comprehensive medical liability reform that includes statutory limits on some damages would reduce federal budget deficits by about $60 billion during the 2011–2020 period, but neither of these two savings proposals are part of the President's budget.

Social Security The Social Security program is in permanent cash deficit. That is, the program is collecting less in payroll taxes than it is paying out in benefits every year into the future. Failure to adopt policy changes will result in substantial benefit cuts for future retirees. Still, the President's budget includes no proposals to strengthen Social Security.

Postal Service Under current law, the Postal Service makes payments to the federal government to fund the health benefits of Postal retirees (the benefits are administered by the Office of Personnel Management). The Administration proposes to allow the Postal Service to reduce these payments by $2.2 billion this year and $4.7 billion throughout the budget window so the Postal Service's annual deficits will be somewhat smaller. The Postal Service received several billion dollars of similar relief from the federal government in 2003 and 2006.

Government Sponsored Enterprises Last week, the Administration released three options to reform Fannie Mae and Freddie Mac. None of these options is reflected in the President's Budget. In the absence of reform, Treasury has already made $149 billion in payments to Fannie and Freddie under the Housing and Economic Recovery Act of 2008. Treasury will make another $48 billion payment to the GSEs this year followed by an additional $40 billion through 2013.

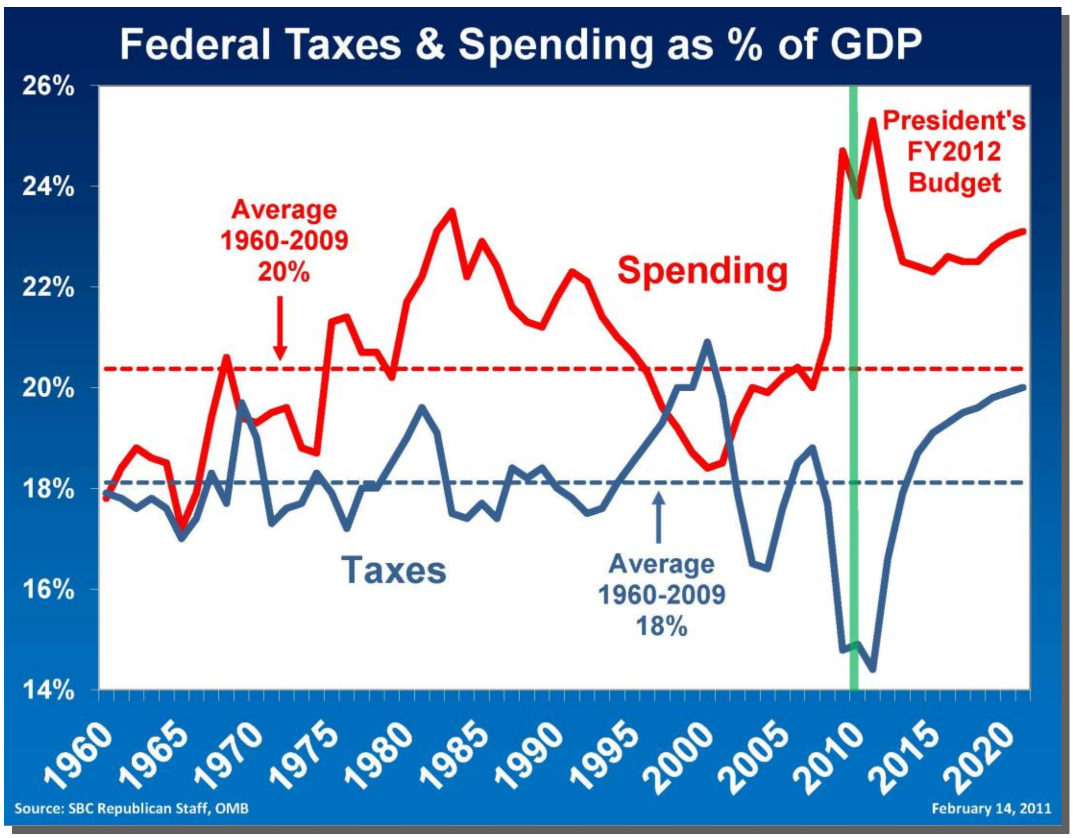
Unemployment Insurance (UI) States now face mounting unemployment insurance debt with 30 states owing the federal government $42 billion as a result of their borrowing to meet unemployment insurance obligations. Responding to this situation, the President's Budget proposes a moratorium on unemployment insurance tax increases and interest payments on federal unemployment insurance loan debt during 2011 and 2012. In 2014, however, the Administration proposes to more than double the level of wages subject to the unemployment tax – from $7,000 to $15,000, a level then indexed to average wages in following years. Under existing law, states must have a state tax wage base at least equal to the federal wage base. This will result in 34 states raising their wage base. While the proposal would reduce the federal UI tax rate, any tax increases in the future, at both the state and federal level, will result in higher taxes on employers then under current law. These tax increases are likely as states struggle to pay back their loans in the future. OMB estimates this proposal would decrease the deficit by $42.3 billion over the 2011-2021 period.

Student Loans and Grants Regarding student loans, the President proposes eliminating the in-school interest subsidy on federal loans for graduate students, saving $29.3 billion over ten years. The President's Budget also proposes incentivizing existing borrowers to switch from guaranteed loans to direct loans, taking advantage of the limitations of credit reform scoring to save $2.2 billion over ten years. As in past budgets, the President would modernize the Federal Perkins Loan program, expanding it to more colleges and making it function more like the Direct Loan program (also scored under credit reform), saving $7.4 billion over ten years.

The Administration would also spend $1.8 billion over ten years for a new College Completion Incentive Grant program and a new Presidential Teaching Fellows program; the latter would be an overhaul of the current TEACH Grant program.

Transportation Trust Fund (TTF) Because the Highway Trust Fund (HTF) has become unsustainable, with transfers from the General Fund of the Treasury totaling $35 billion over the past three years, the Administration is proposing to revamp it along the lines of the proposal made by the President's Fiscal Commission. First, the Administration would expand the number of programs covered by the renamed Transportation Trust Fund, including additional highway safety, transit, and passenger rail programs and a new National Infrastructure Bank. The proposal would reclassify all outlays associated with these programs as mandatory, subject to the PAYGO law, eliminating one byzantine feature of the current program that makes it impossible for most people to understand how the program operates. As the budget is proposing to increase spending on such transportation programs even above the current level of spending that already outstrips gas tax revenues paid into the HTF, it also “assumes bipartisan agreement on new revenues sufficient to keep the [TTF] solvent” over 10 years. But the budget document warns that "[t]hese estimates are a placeholder and do not assume an increase in gas taxes or any other specific proposal to offset surface transportation spending."

Spectrum The President proposes a Wireless Innovation and Infrastructure Initiative to reallocate portions of the electromagnetic spectrum from federal agencies and commercial users to higher uses. First, the budget seeks legislation that would extend the authority of the Federal Communications Commission (FCC) to auction spectrum past its current expiration of 2012, and to allow the FCC to conduct incentive auctions, where the auction proceeds are shared between the Treasury and the incumbent user of the spectrum who would be vacating it. While the Administration expects such auctions would yield a gross $27 billion over the next 10 years, it also proposes to spend $17 billion of that amount on communications equipment for state and local first responders and to increase access to wireless broadband. On net, the proposal would reduce the deficit by only $10 billion.


Federal Taxes & Spending as % of GDP
26%
24%
22%
20%
18%
16%
14%
President's
FY2012
Budget
Average
1960-2009
20%
Spending
Taxes
Average
1960-2009
18%
1960
1965
1970
1975
1980
1985
1990
1995
2000
2005
2010
2015
2020
Source: SBC Republican Staff, OMB
February 14, 2011

Budget Process Reform Proposals

<u>Expedited Rescission</u>. 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.

<u>Limit on Advance Appropriations</u>. Although the Congressional budget resolution has historically set an advanced appropriation limit, the Administration proposes that the advanced appropriations limit in the 2012 Budget should be $28.821 billion for 2013 and remain at that level for subsequent years.

A DEBT LIMIT INCREASE BEYOND COMPREHENSION

What does it mean to "borrow too much"? The truth can be found by looking at the levels of debt. The debt doesn't lie.

According to Treasury Secretary Geithner, the federal government's current debt limit of $14.294 trillion will be reach within the next 2-3 months. He's asked the Congress to enact legislation to increase the limit, but he's leaving it up to Congress to decide by how much.

Under the policies in the President's 2012 budget, Congress would have to increase the limit by $1.165 trillion *just to fund the government through September of this year.*

If Congress doesn't want to deal with the debt limit again until after the 2012 elections, it needs to raise the limit by more than $2.5 trillion.

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, 2011 Economic and Budget Outlook* and those contained in the *Blue Chip Economic Indicators* (which are averages of around 50 private forecasts). The Administration projects GDP growth that is around one-half of a percent higher in 2012 and over one percentage point higher in 2013.

The Administration projects a higher economic growth rate than other forecasters over the entire 10-year budget window.

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 at or below 2.0% through 2012, with an eventual edging up above 2.0% in the longer term. The Administration sees inflation edging up to 2.1% by 2016 and remaining at that rate for the remainder of the 10-year window. CBO projects a mild acceleration of inflation from 2014 to 2017, where inflation peaks at 2.4%, thereafter stabilizing at 2.3%.

The Administration's near-term forecast for the civilian unemployment rate is close to both the Blue Chip and CBO forecasts. The Administration expects the unemployment rate to be 9.3% in 2011, subsiding slightly to 8.6% in 2012 and edging down further to 7.5% in 2013. The Administration sees unemployment falling to 5.3% by 2017 and remaining stable at that rate for the remainder of the 10-year budget window, close to the 5.2% rate where CBO sees the unemployment rate stabilizing beginning in 2018.

It is notable that unemployment is expected by all forecasters to remain stubbornly high for years to come. Indeed, the Administration does not expect the unemployment rate to fall below 7.5% until 2014. Evidently, the Obama Administration is not confident that its policies will be successful in reducing 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*[1]) and *CBO's January, 2011 Economic and Budget Outlook*.

Real GDP growth CY2011		**Real GDP growth CY2012**		**Real GDP growth CY2013**	
Obama:	+2.7%	Obama:	+3.6%	Obama:	+4.4%
Blue Chip:	+2.5%	Blue Chip:	+3.2%	Blue Chip:	+3.0%
CBO:	+2.7%	CBO:	+3.1%	CBO:	+3.1%
Inflation (CPI-U) CY2011		**Inflation (CPI-U) CY2012**		**Inflation (CPI-U) CY2013**	
Obama:	+1.3%	Obama:	+1.8%	Obama:	+1.9%
Blue Chip:	+1.5%	Blue Chip:	+2.0%	Blue Chip:	+2.2%
CBO:	+1.6%	CBO:	+1.3%	CBO:	+1.6%
Unemployment rate CY2011		**Unemployment rate CY2012**		**Unemployment rate CY2013**	
Obama:	9.3%	Obama:	8.6%	Obama:	7.5%
Blue Chip:	9.3%	Blue Chip:	8.4%	Blue Chip:	7.7%
CBO:	9.4%	CBO:	8.4%	CBO:	7.6%

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