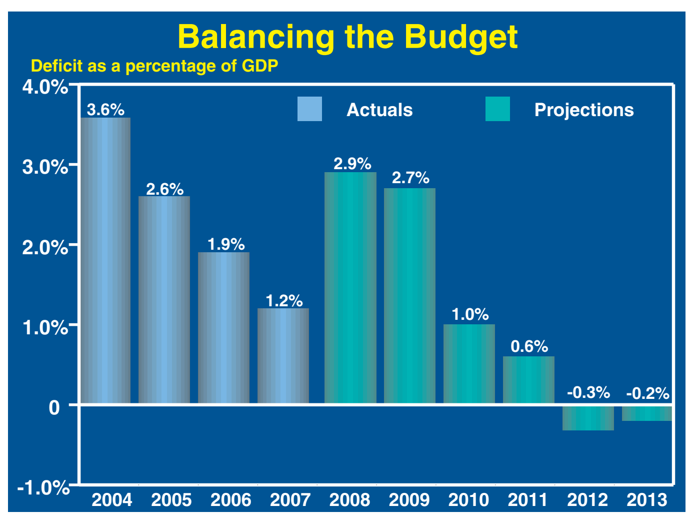
THE NATION'S FISCAL OUTLOOK

The President's 2009 Budget proposes to boost near-term economic growth, restrain spending, and reform entitlements, leading to a balanced budget by 2012 and a more fiscally prudent path for the long term. By adopting pro-growth economic policies and spending restraint, the President has succeeded in reducing the deficit. The deficit fell in 2007 for the third year in a row and was very low by historical standards. Despite these recent improvements in the deficit and an economy that retains a solid foundation, short-term economic challenges exist and the strong economic growth of the last few years cannot be taken for granted. The 2009 Budget includes an economic growth package that will provide temporary and immediate tax relief to bolster consumer spending and business investment in order to maintain a healthy economy and ensure that the Budget remains on a path to balance.

While achieving a balanced budget in 2012 is important, the longer-term budget outlook remains sobering. Rising health care costs and the aging of the Nation's population are expected to put enormous and unsustainable pressures on Medicare, Medicaid, and Social Security. The 2009 Budget proposes to begin addressing the Nation's long-term fiscal challenges by reforming these programs in a sensible way. The President is committed to meaningful entitlement reform that will preserve these vital programs for future generations.

BALANCING THE BUDGET IN THE NEAR-TERM

The 2009 Budget continues to reflect the President's priorities of promoting economic growth and restraining Federal spending, which benefit both taxpayers and the Nation's treasury. The September 11th terrorist attacks, the subsequent Global War on Terror, and Hurricane Katrina all put significant fiscal pressures on the Federal budget. Despite these challenges, the deficit fell $250 billion in the last three years.

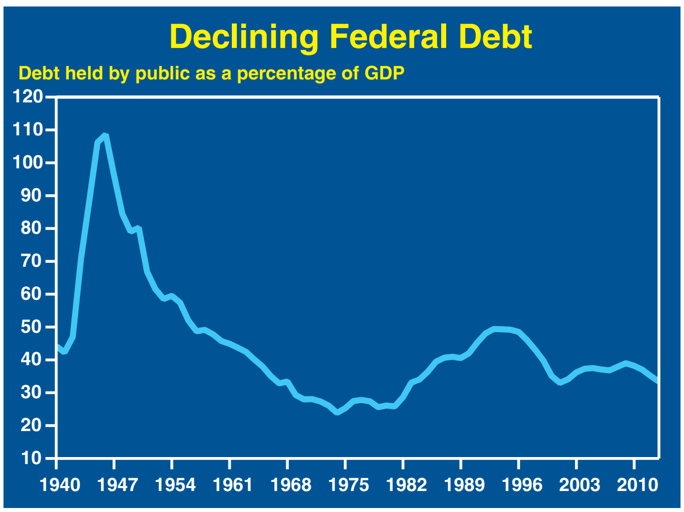


For 2007, the deficit was $162 billion, lower than the deficits in each of the previous four years. To compare annual deficits over a period of time, it is helpful to consider the deficit in comparison to the size of the Nation's economy, typically represented by gross domestic product (GDP), or the total amount of final goods and services produced in the economy.

The 2007 deficit was 1.2 percent of GDP, well below the 40-year average of 2.4 percent of GDP. Four years ago, the President announced in his 2005 Budget that by 2009 he would cut the deficit in half from its projected peak. The President achieved his goal three years ahead of schedule, in 2006, when the deficit fell from a projected peak of 4.5 percent of GDP, or $521 billion, to 1.9 percent of GDP, or $248 billion. Last year, the President announced a new goal of balancing the budget. The policies in this Budget continue the effort to reach that goal.

The 2008 deficit is projected to be $410 billion, or 2.9 percent of GDP, and the 2009 deficit is projected to be $407 billion, or 2.7 percent of GDP. The primary reason for increasing deficits in the near term is the President's economic growth package and an expected slowing of receipt growth, due to an expected reduction in corporate tax receipts from recent high levels. Another reason for increases in the projected near-term deficits is increasing defense and emergency spending.

The Budget reflects the full cost of the Global War on Terror for 2008. Actual funding needs for 2009 and beyond will be determined by security conditions in Iraq and Afghanistan, and will continue to be evaluated. In addition, the Budget reflects a one-year extension of Alternative Minimum Tax relief for the 2008 tax year and an allowance for the cost of an economic growth plan. The Budget proposes to allow Americans to invest in voluntary personal retirement accounts beginning in 2013 and makes permanent the President's tax relief. Taken together, the President's policies are expected to lead to fiscal improvements, with a deficit of $160 billion, or 1.0 percent of GDP, in 2010 and surpluses of $48 billion and $29 billion, or 0.3 percent and 0.2 percent of GDP, projected for 2012 and 2013, respectively.



To understand the Nation's fiscal outlook, it is helpful to consider both the budget deficit and the amount of debt held by the public. Debt held by the public reflects the amount of money that the Government has borrowed from outside the Government to finance current and past deficits. Debt held by the public has ranged from 33 to 49 percent of GDP over the past 20 years and averaged 35.6 percent over the past 40 years. At the end of 2007, debt held by the public was $5.035 trillion, or 36.8 percent of GDP, falling from 37.1 percent in 2006. For 2012, debt held by the public is projected to be 35.1 percent, below the long-term historical average. Declining deficits and reductions in the debt held by the public demonstrate that the President's pro-growth policies, coupled with spending restraint, are working to improve the Nation's fiscal outlook.

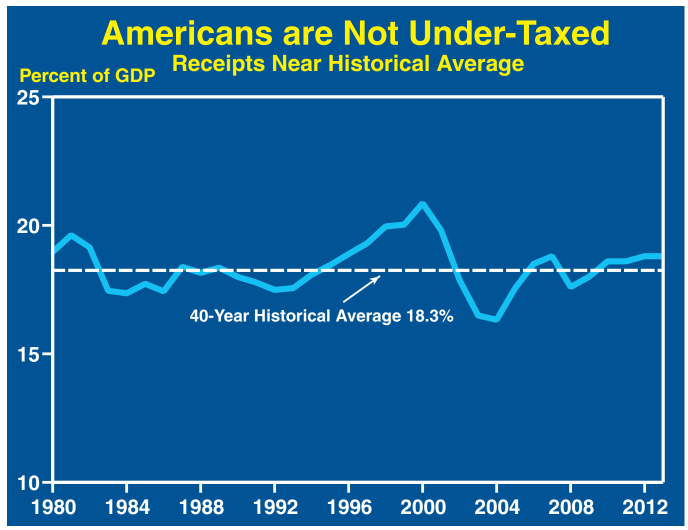
Promoting Economic Growth

The foundation for the President's pro-growth economic agenda is his tax relief policy. Permitting hard-working individuals to keep a greater portion of their income and encouraging prudent risk-taking among investors create an economic climate in which workers and businesses thrive. Through the President's tax relief efforts, tax rates for individual income, capital gains, dividends, estates and gifts have all been cut. In addition, the President's efforts have doubled the child tax credit, reduced the marriage tax penalty and increased incentives for retirement savings, education savings, and small business investment.

Since the President's tax relief program was fully implemented in 2003, the economy has created more than 8.3 million jobs. The jobs gains and relatively low unemployment reflect the sustained economic growth of the past six years, a period during which real GDP growth averaged 2.8 percent per year.

The growth in tax receipts in recent years has been particularly impressive. 2007 was the third year in a row in which receipts grew faster than GDP. The strong showing in 2007—with tax receipts of $2.568 trillion, 6.7 percent greater than in 2006—follows two years of double-digit growth in receipts in 2005 and 2006, with 2005 witnessing a 14.5 percent increase and 2006 witnessing an 11.8 percent increase. At 18.8 percent of GDP, receipts for 2007 were above the 40-year historical average of 18.3 percent.

Even with this recent strong economic and receipt growth, 2008 has already shown mixed economic signals and the Administration recognizes that economic growth cannot be taken for granted. For this reason, the Budget reflects an allowance for an economic growth plan that provides an immediate and temporary boost to private-sector spending and investment. The President has called on the Congress to work with him to enact a package that provides tax relief for individuals and tax incentives for businesses, and that is substantial enough to have an impact on the Nation's large and dynamic economy. Any economic growth package should be built on broad-based tax relief and should not include any tax increases.



The 2009 Budget proposes to continue, for the longer term, tax policies that promote entrepreneurship, job creation, and economic growth. The Budget proposes to make permanent those provisions of the 2001 and 2003 tax relief packages that are set to expire at the end of this decade. The Budget also proposes tax modifications to close loopholes, simplify the tax code for families, increase compliance, promote retirement savings, increase small business investment, and make health care affordable for all Americans.

In addition to tax relief, the President will continue to promote economic growth through many other initiatives. Specifically, the Administration is working to: advance basic research and development; promote innovation and accountability in education; reduce the paperwork burden and unnecessary regulations imposed on business; reduce costly and unnecessary litigation; open new markets for American exporters; and advance pro-growth energy policies.

Protecting Americans

Keeping Americans safe, both at home and abroad, continues to be the President's top priority, and the President believes that being both safe and free is essential to the Nation's continued prosperity. In his 2009 Budget, the President proposes funding levels that will continue the Global War on Terror militarily and diplomatically, and that will transform the military for the 21st Century.

Between 2001 and 2007, security spending increased 48 percent overall. Spending increased 43 percent for the Department of Defense, 219 percent for homeland security, and 46 percent for international affairs (non-homeland). These increases were essential after the September 11th terrorist attacks on the Nation's homeland.

The 2009 Budget proposes an 8.2 percent increase in total security spending. A 7.5 percent increase for defense will be used to maintain a high level of military readiness that can support the Global War on Terror and respond, if necessary, to other military threats. In addition, the defense increase will be used to continue to transform the military to ensure that it has the flexibility to meet ever-changing defense challenges. To protect the Nation's homeland, the Budget proposes a 10.7 percent increase in funding for improving nuclear detection capabilities, expanding cyber security protections, securing the Nation's borders and removing those individuals in the country illegally, and developing stronger identification and screening capabilities. To support the Nation's diplomatic and international development efforts overseas, the Budget proposes a 14.9 percent increase for international affairs. These funds will be used primarily to support key allies in the Global War on Terror and improve response to international crises, to promote democracy throughout the world, to expand education for the world's poorest children, and to combat global HIV/AIDS and malaria.

Slowing Growth in Non-Security and Entitlement Spending

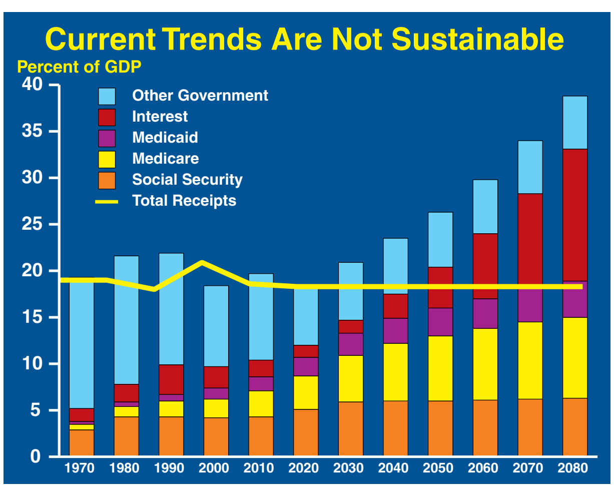
Several years of strong receipt growth and spending restraint have improved the near-term budget outlook. Total outlays for 2007 were $2.73 trillion, or 20.0 percent of GDP, slightly below the 40-year historical average of 20.6 percent. Outlays in 2007 were only 2.8 percent higher than in 2006, representing the smallest percentage increase in outlays in 10 years.

The Budget will maintain 2009 outlays as a share of GDP at close to the historical level of 20.6 percent by restraining non-security spending and entitlement growth. The Budget proposes sensible reforms to entitlement programs that result in savings of $16 billion in 2009, $208 billion over the five-year budget horizon and $619 billion over the 10-year horizon. In total, the Budget proposes to eliminate or reduce 151 discretionary programs, saving over $18 billion in 2009.

As discussed below, the majority of entitlement savings, $603 billion over the 10-year period, are derived from reforms to Medicare and Medicaid. In addition to changes to Medicare and Medicaid, the Budget proposes to increase premiums paid to the Pension Benefit Guaranty Corporation, eliminate Social Services Block Grants, terminate the Perkins loan program, and modify the Disability Insurance program.

FACING FUTURE BUDGETARY CHALLENGES

For the near-term, the 2009 budget deficit is projected to equal 2.7 percent of GDP, with smaller deficits in the years that follow and small surpluses projected beginning in 2012. Although the five-year budget horizon projects manageable deficits by historical standards, and even small surpluses beginning in 2012, the long-term outlook is much less optimistic.

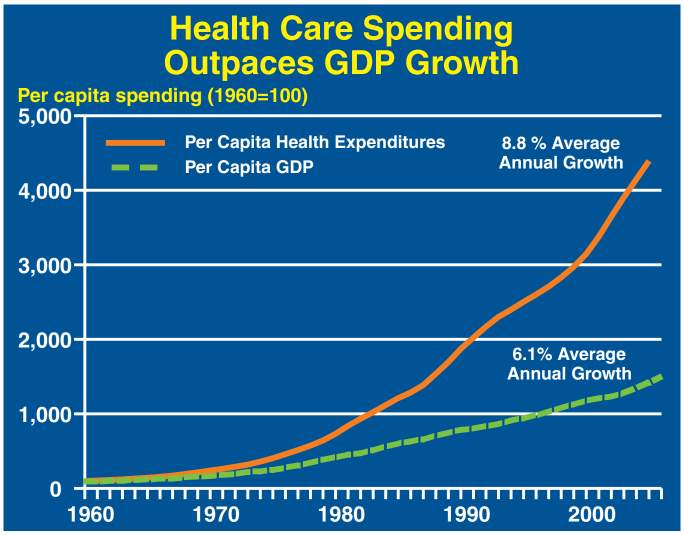


Long-term projections of all Government programs and interest on Government debt show that by 2080, the deficit could exceed 20 percent of GDP if receipts are held at the 40-year historical average of 18.3 percent of GDP. In addition, these deficits could lead to unsustainable levels of borrowing, with debt held by the public exceeding 280 percent of GDP by 2080.

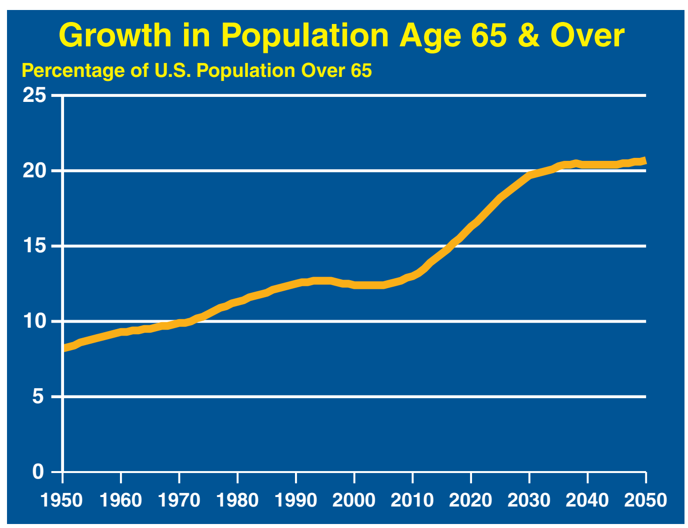
To understand how the Nation might avert a fiscal crisis, it is helpful to review how the Nation arrived on its current fiscal path. In 1970, spending on the Government's three largest entitlement programs—Medicare, Medicaid, and Social Security—was equal to 3.8 percent of GDP. This figure has more than doubled, reaching 8.4 percent today. If health care costs continue to outpace inflation, 75 years from now spending on these three programs is projected to be 19 percent of GDP. This means that in 2080 these three programs alone could account for about as much spending, expressed as a percentage of GDP, as total Government spending does today.

Health Care Costs and Longer Life Expectancy Impact Federal Programs

The reasons for the projected dramatic increases in costs for Medicare, Medicaid, and Social Security are growing health care costs and an aging population.



First, since 1960, health care costs have grown 2.7 percentage points faster per year than the economy as a whole. This growth in overall health care costs is particularly problematic for the Federal Government because it is the Nation's largest purchaser of health care, accounting for approximately one-third of all health care spending in the country. The Government provides health care to seniors and low-income individuals through its two largest health care programs, Medicare and Medicaid, and to veterans, active duty military, and civilian personnel through a number of other programs. In 1966, Medicare and Medicaid accounted for only 1 percent of all Government expenditures, but now they account for 20 percent. The Medicare program's Board of Trustees assumes that Medicare costs will continue to outpace overall economic growth by an average of 1 percent per year over the next seven decades.



Second, beginning this year, the first of the Nation's 78 million baby boomers, those individuals born between 1946 and 1964, will begin to collect retirement benefits under Social Security. Three years from now, beginning in 2011, these oldest baby boomers will be eligible for Medicare benefits. Compounding this unprecedented growth in new beneficiaries are the continued growth in life expectancy and the decline in the working population relative to the retired population. Over the next 25 years, the share of the population aged 65 and older is forecast to increase from 12 percent to 20 percent, and the share of the population that is working in paid employment is forecast to fall from its current 60 percent to 55 percent.

The first factor affecting the Government's long-term costs, health care cost growth, cannot be predicted with certainty, but can be influenced significantly by Government policies. The second factor, the aging of the Nation's population, can be predicted with a fair degree of certainty. The Budget takes into account these economic and demographic realities by proposing practical policy changes to alleviate some of the long-term fiscal pressure that the Government will be facing. In an attempt to reduce the growth in overall health care costs and the costs of Medicare and Medicaid in particular, the Budget is proposing a number of health care reforms. In addition, the Budget proposes several sensible reforms to Social Security. These proposals, coupled with other Budget proposals, are important and meaningful steps to putting the Nation on a more prudent fiscal path.

Strengthening Social Security

Because of the increase in the number of retirees, increasing life expectancy, and the resulting decline in the number of workers relative to the retiree population, Social Security benefit payments are projected to exceed the program's dedicated cash income beginning in 2017. This mismatch between benefit payments and cash income must be addressed, and the sooner it is addressed, the more moderate and fair the changes to the program can be.

The President is committed to strengthening Social Security and supports a bipartisan reform process in which all participants are encouraged to bring options for strengthening Social Security to the table. The Budget reflects the President's proposal to allow workers to use a portion of the Social Security payroll tax to fund voluntary personal retirement accounts. These accounts would give Americans an opportunity to build a nest egg and pursue a higher return on their payroll taxes than is possible in the current system, thereby giving them greater control over their retirement finances. Under the President's proposal, beginning in 2013 workers will be allowed to use up to four percent of their Social Security taxable earnings, up to a $1,400 annual limit, to fund their personal retirement accounts. The $1,400 cap will be increased by $100, adjusted for wage growth, each year beginning in 2014 and continuing until 2018.

The President has also embraced the idea of progressive indexing as part of a solution to restore Social Security to sustainable solvency. Over time, wages tend to rise faster than prices. Currently, the first Social Security payment that a person receives is based on a formula that indexes an individual's earnings to the rate of growth in wages. Under progressive indexing, a lower wage earner would continue to have his or her earnings indexed to wage growth, but a higher wage earner would have his or her earnings indexed to inflation; middle-income workers would receive benefits that are indexed in part to wage growth and in part to inflation. By providing a higher rate of indexing for lower wage workers than for higher wage workers, progressive indexing protects those who most rely on Social Security.

REFORMING HEALTH CARE

In his Budget, the President proposes reforms to the Nation's health care system including private health insurance and the Federal health care programs of Medicare, Medicaid, and the State Children's Health Insurance Program (SCHIP). The President's proposals are designed to give all Americans access to affordable health care and to address the cost pressures health care places on the economy and the Federal budget.

The President proposes replacing the existing—and unlimited—tax exclusion for employer-sponsored insurance with a standard health insurance tax deduction. As long as families have at least a catastrophic health insurance policy, they will be able to deduct $15,000 from their income ($7,500 for an individual). This will foster a true marketplace for health care, encourage competition, improve the efficiency of the system, and reduce the ranks of the uninsured.

The Budget also proposes three initiatives to restructure health insurance markets. The first will establish association health plans to allow small employers, civic groups, and community organizations to use collective purchasing power to negotiate lower-priced coverage for their employees, members, and their families. The second will create a competitive marketplace across State lines, which will maintain strong consumer protections. The third will reform medical liability law to increase access to high-quality, affordable health care for all Americans and to reduce frivolous, time-consuming legal proceedings against doctors and health care providers.

The President continues his commitment to consumer-focused policies that emphasize transparency of price and quality information. The Budget proposes to modify the standard IRS W-2 form to require employers to include the amount they paid for health insurance premiums on each employee's behalf. Additionally, the Budget contains a package of proposals that promote the use of health savings accounts, including allowing health plans with at least 50 percent coinsurance to qualify as high-deductible health plans.

To help States offer health insurance options to hard-to-insure populations, the President proposes $75 million in both 2009 and 2010, as authorized by the State High Risk Pool Funding Extension Act of 2006.

Fostering Affordable Choices in the Health Care System

Over the past year, the Secretary of Health and Human Services (HHS) has spoken with various health care stakeholders, including the Nation's governors and Members of Congress, about opportunities to improve access to affordable insurance.

The Federal Government's current system of paying for health care results in billions of dollars being spent inefficiently through a patchwork of subsidies and payments to providers. In addition to directly funding the costs of health care for enrollees, the Medicare and Medicaid programs make separate payments that subsidize a provider's operating expenses or fund indirectly the cost of uncompensated care. The health care system could operate more efficiently if some portion of these separate payments to institutions were redirected to help people with poor health or limited income afford health insurance. The uninsured often use emergency rooms as a source of primary care, which leads to suboptimal care and spending outcomes. If this spending were focused on helping the uninsured purchase private insurance, people would receive the care they need in the most appropriate setting.

The health care system needs to be transformed in a way that avoids costly and unnecessary medical visits and emphasizes up-front, affordable private health insurance options. This transformation could happen by subsidizing the purchase of private insurance for low-income individuals. However, any such health care reforms need to be State-based and budget neutral within health care spending, and must not result in the creation of a new entitlement program or affect savings proposed in the President's Budget. The Federal Government would maintain its commitment to the neediest and most vulnerable populations, while acknowledging that States are best situated to craft innovative solutions to move people into affordable insurance.

Preserving Quality, While Slowing the Unsustainable Growth in Medicare

The Medicare program, established in 1965, offers health care services to individuals aged 65 and older and certain people with disabilities. In 2007, nearly 44 million people were enrolled in the Medicare program. Medicare has traditionally consisted of two parts: Hospital Insurance, also known as Part A, and Supplementary Medical Insurance, also known as Part B. The Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (MMA) reformed Medicare by providing new voluntary prescription drug coverage, also known as Part D, which began on January 1, 2006. In addition, the MMA created the Medicare Advantage program, also known as Part C, which offers greater choices and higher-quality care to beneficiaries through competition among private health plans. These programs offer Medicare beneficiaries additional coverage, more choice, and health care savings.

According to the 2007 Medicare Trustees' Report, Medicare's dedicated revenues from designated payroll taxes and from premium payments covered 59 percent of benefits in 2006. The remaining 41 percent was financed from general tax revenues. By 2030, dedicated revenues are projected to finance only 47 percent of total Medicare benefits, leaving 53 percent of program costs to be funded by general tax revenues. This projected rate of growth in Medicare benefits is not sustainable over the long run.

The Administration is committed to reforming Medicare to ensure efficient and high-quality care and to improve the fiscal sustainability of the program for the future. Currently, Medicare spending is growing at an annual rate of 7.2 percent. The 2009 Budget includes proposals to slow the annual rate of growth in the Medicare program to 5.0 percent. Over five years, these proposals are estimated to produce a total of $178 billion in savings.

Improving Fiscal Sustainability

The Administration is committed to slowing Medicare's rate of growth while also promoting the delivery of high-quality services to program beneficiaries. For two consecutive years, the Medicare Trustees have found that more than 45 percent of projected Medicare expenditures will require funding from general tax revenue (rather than dedicated resources) within the current or next six years. Accordingly, the Budget proposes legislation that will reduce Medicare spending by $556 billion over 10 years and more than $10 trillion over 75 years.

In addition to proposing specific reforms to reduce the unsustainable growth in the near term, the Budget also proposes to address the long-term unfunded obligation in Medicare by adding to the MMA funding warning an incentive for Medicare reform. Specifically, in the year in which the 45-percent threshold is exceeded, provider payments would be automatically reduced by four-tenths of one percent per year. The provider payments would continue to be reduced by an additional four-tenths of one percent per year as long as Medicare's dedicated funding sources cover 55 percent or less of program costs. The provision is intended to encourage the Congress and the Administration to reach agreement on reforms needed to slow the growth in program costs.

Encouraging Provider Competition, Efficiency, and High-Quality Care

Competition and efficiency improve care for beneficiaries by encouraging quality and lowering costs. The 2009 Budget proposes to adjust annual provider updates to encourage implementation of best practices that will restrain costs and improve efficiency. The Budget supports payment reforms for providers, such as hospital value-based purchasing, that do not increase Medicare spending and that encourage providers to administer high-quality, efficient care. In addition, the Budget proposes incentives that encourage high-quality hospital services and reduce medical errors. The Budget also proposes to introduce more competition into Medicare by establishing competitive bidding for clinical laboratory services and accelerating the transition to competitive contracts for fee-for-service claims processing.

Aligning Medicare Payments with Current Costs and Practices

Medicare's payment policies need to be updated to keep pace with evolution in health care treatments and settings. The Budget includes proposals that ensure that patients are served in the most medically appropriate and cost-efficient setting for post-acute care, and that payments for medical equipment and services do not exceed their costs.

Increasing Beneficiary Responsibility for Health Care Choices

One reason for the excessive growth in health care spending is the lack of knowledge consumers have about their health care choices and costs. The Budget proposes to encourage greater individual responsibility for health care use and costs for high-income beneficiaries, who are most able to contribute to the costs of their coverage. This will be facilitated by a number of steps the Administration has taken already that increase the transparency of health care costs and quality, and support greater health care value for Medicare beneficiaries.

Improving Program Integrity

Medicare program integrity efforts have yielded savings from the recovery of overpayments and the collection of criminal fines and penalties from Medicare fraud. The Budget proposes additional funds to address program integrity vulnerabilities.

Promoting Fiscal Responsibility in SCHIP and Medicaid

Established in 1997, SCHIP provides health care coverage to low-income, uninsured children who do not qualify for Medicaid. The Medicare, Medicaid, and SCHIP Extension Act of 2007, P.L. 110-173, extended SCHIP funding through March 31, 2009. The President's Budget includes a robust SCHIP reauthorization proposal that refocuses SCHIP on low-income children, as was originally intended.

Established in 1965, Medicaid is an open-ended health care entitlement financed jointly by the Federal Government and States. The Federal Government pays, on average, 57 percent of Medicaid expenses. In 2009, it will cover approximately 51 million low-income children and families, pregnant women, seniors, and disabled individuals. Federal Medicaid outlays are estimated to be $218 billion.

Focusing SCHIP Coverage on Low-Income Children

The President is fully committed to reauthorizing SCHIP in a fiscally responsible manner. It is critical that SCHIP be reauthorized in a way that continues to cover the Nation's neediest children.

The Administration and the Congress have not been able to find common ground on the best way to reauthorize SCHIP. The Budget includes a fiscally responsible reauthorization proposal that would cover, on average, 5.6 million low-income children by 2013.

When SCHIP was established, the focus was on low-income children, primarily children below 200 percent of the Federal poverty level. The Budget continues to focus on these children by increasing funding to States by $19.7 billion through 2013. The Budget also includes outreach grants of $50 million in 2009 and $100 million in each of the following four years for States, localities, schools, and community-based organizations to reach eligible uninsured children.

At the same time, the Administration proposes policies that will increase the long-term sustainability of SCHIP. The Budget reauthorization proposal helps those who are now uninsured obtain health insurance, but does not move those who now have private health insurance into Government programs. The Budget also clarifies SCHIP eligibility by clearly defining income.

Enhancing Access to and Ensuring Continuity of Health Coverage

The Budget includes proposals to ensure continued access to health care for eligible individuals. First, the Budget proposes to extend coverage through September 30, 2009, for Medicaid beneficiaries who qualify for Transitional Medical Assistance benefits or who qualify for Medicare

Part B premium assistance as Qualified Individuals. Second, the Budget proposes modifications to the Health Insurance Portability and Accountability Act of 1996 to give greater continuity in coverage for Medicaid/SCHIP beneficiaries. Lastly, the Budget proposes modifications that will make it easier for States to implement premium assistance programs.

Strengthening Program Integrity and Accountability in Medicaid

In addition to proposals that enhance access and continuity of coverage, the Budget proposes reforms to improve program integrity, increase State flexibility, and promote cost-effective management of Medicaid dollars. Many reforms build on past efforts by the Congress and the Administration to improve Medicaid fiscal integrity and to increase program efficiencies.

Long-Term Care. To preserve Medicaid for the neediest individuals, the Budget proposes to maintain the home equity limit, which partly determines an individual's eligibility for Medicaid Long Term Care (LTC), at $500,000. The Budget also proposes to give States more flexibility to tailor acute care benefits in a manner that better meets the needs of higher-income LTC populations. The Budget further includes an administrative action to clarify what types of inflation protection must be included in LTC insurance plans offered through the Partnership for LTC program.

Managed Care. To ensure that savings generated by managed care are spent appropriately and to remove ambiguity about how those savings can be used, the Administration will issue a regulation detailing which services are allowable under section 1915(b)(3) of the Social Security Act. Additionally, to give States greater flexibility in coordinating care for special populations, the Budget proposes to allow States to require all Medicaid beneficiaries to be enrolled in managed care. Further, the Administration proposes extending the renewal period for section 1915(b) waivers from two years to three years to simplify program administration.

Prescription Drugs. The President supports market-based prescription drug reforms. The Budget proposes to remove "best price" from the Medicaid rebate calculation to allow manufacturers to negotiate deeper discounts in the private sector without affecting rebate levels. The Budget also proposes to rationalize reimbursement for multiple-source prescription drugs and to implement Medicare-Medicaid drug claim data sharing, which would allow States to better manage beneficiary care.

Reimbursement Reform. The Federal Government generally reimburses States for medical services at the statutory Federal Medical Assistance Percentage (FMAP) and at 50 percent for administrative activities under Medicaid, but exceptions exist. To create consistency and preserve the integrity of the matching structure across Medicaid, the Budget proposes to align reimbursement for family planning services and for premium assistance provided to Qualified Individuals at FMAP. The Budget also proposes to align reimbursement rates for all Medicaid administrative services and case management at 50 percent.

Financing Reforms. The Budget proposes to restructure Medicaid financing to increase program efficiencies and fiscal integrity. The Budget proposes to recoup duplicative administrative payments that were inappropriately included in the Temporary Assistance for Needy Families block grants. Also, the Administration will codify the longstanding HHS policy not to bill Medicaid when services are provided free of charge to the public.

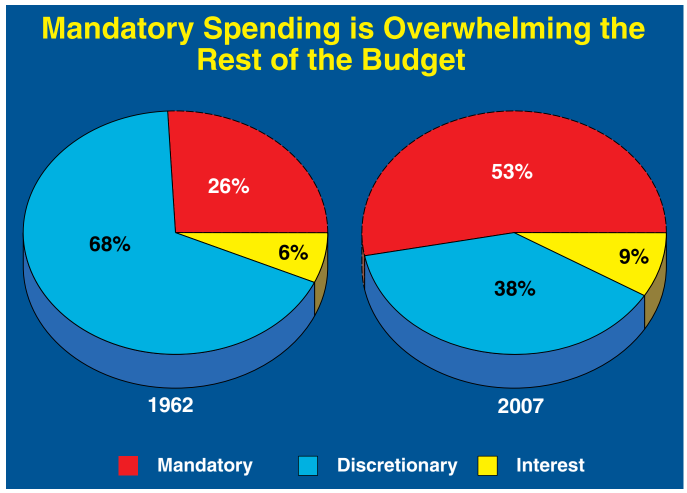
Reducing Improper Payments. The Budget includes proposals that will help States reduce improper payments, including: 1) enhancements to third-party liability law that strengthen Medicaid's position as payer of last resort; 2) two proposals that give States tools to help identify improper provider claims and duplicative benefits received by the same beneficiary in more than one State; and 3) a permanent extension with modifications of a demonstration using web-based tools to verify the assets of Medicaid applicants.

Accountability and Transparency. The Budget proposes to require States to report on performance measures and link State performance to grant awards. The Budget also proposes to require an annual report on Medicaid's financial status.

COMMON-SENSE BUDGET REFORMS

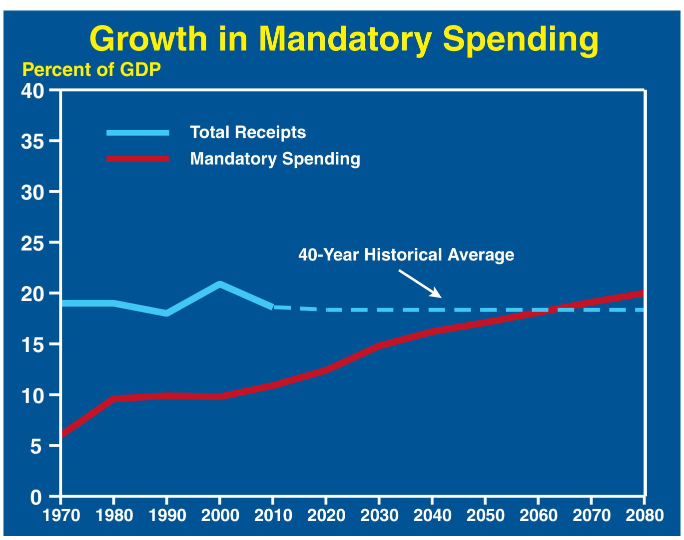
With tax relief and other pro-growth policies, plus his proposals to limit discretionary spending and reduce the future costs of the Nation's major entitlement programs, the President has demonstrated his commitment to fiscal responsibility. In this Budget, the President is again proposing a number of common-sense reforms to improve the way that the Congress and the President make decisions about how best to spend taxpayer dollars.

Restraining Automatic Spending



Nearly two-thirds of all Government spending occurs automatically, without any action by the Congress or the President. This spending includes payments for interest on Federal debt and spending for "entitlement" programs in which the law specifies both the criteria that entitle an individual to a payment from the Government and the formula that establishes the amount of the payment. The automatic nature of spending for entitlement programs ensures that the health care and income needs of seniors and persons who are disabled, widowed, or orphaned will be met. Because interest and entitlement program spending is automatic or "mandatory," the Congress and the President must enact legislation to change the path of this spending.

As a share of total Government spending, mandatory spending has grown dramatically over the past four decades. In 1962, mandatory spending accounted for 26 percent of all Government spending. By 2007 that percentage had more than doubled, reaching 53 percent.



In relation to GDP, mandatory spending has also more than doubled from 1962 to 2007, growing from 4.9 percent of GDP to 10.6 percent. If changes to entitlement programs are not made, mandatory spending is projected to increase to 20 percent of GDP by 2080, which, as a share of GDP, would be roughly equal to total Government spending today. Stated differently, if left unchanged, mandatory spending alone is projected to exceed total projected Government receipts in approximately 50 years.

To prevent the mandatory spending problem from becoming worse while also keeping taxes low, the Budget proposes to impose a new statutory pay-as-you-go requirement on any legislation that affects mandatory spending. Under the proposal, any legislation that increases mandatory spending could not result in an increase in the deficit; any increase would have to be offset by a reduction in mandatory spending in the same or other mandatory programs. Any legislation that increases mandatory spending without an equal offset would be subject to a point of order and would need 60 votes, or a three-fifths vote, in the Senate. If, at the end of a congressional session, the enacted mandatory spending legislation results in an increase in the deficit, then OMB would be required to make across-the-board cuts to non-exempt mandatory programs to eliminate any deficit increase. Unlike the current pay-as-you-go rules adopted by the Congress, the Administration's pay-as-you-go proposal would be statutory and could not simply be waived by 60 votes in the Senate. In addition, the Administration's proposal would ensure that additional spending is not financed by burdening the American people with additional taxes.

In addition to the pay-as-you-go rule for mandatory spending, the Budget proposes to curtail expansions in long-term obligations for Social Security, Supplemental Security Income, Medicare, Federal civilian and military retirement, and veterans disability compensation. Under the proposal, any legislation that increases the actuarial unfunded obligation of any of these programs would be subject to a point of order, or a three-fifths vote, in the Senate.

Restraining Annually Appropriated Spending

As distinct from mandatory spending, which occurs automatically without new congressional or Presidential action, "discretionary" spending is subject to annual review and appropriations action by the Congress and the President. Without laws enacting annual appropriations, most agencies cannot obligate or spend money to carry out their day-to-day operations. Discretionary spending has tended to increase steadily over time, which is why the President's Budget proposes to place statutory limits or "caps" on discretionary spending each year beginning in 2009 and continuing through 2013. Under the proposal, any appropriations bill that causes the caps to be exceeded would be subject to a point of order, or a three-fifths vote, in the Senate. If the total spending enacted in the appropriations laws exceeds the spending caps in any year, OMB would be required to make across-the-board cuts to reduce total discretionary spending to the statutory limit.

The Budget proposes to exempt program integrity efforts from the proposed statutory spending caps by adjusting the caps for amounts dedicated to such efforts. Program integrity efforts are intended to stop payments to individuals not eligible for benefits and to collect unpaid taxes due the Government and can generate as high as a ten-to-one return to the Government.

Spending Tax Dollars Wisely

Legislative Line-Item Veto. In his Budget, the President is again proposing that the Congress enact a legislative line-item veto. Under the proposal, if the Congress were to enact legislation that includes wasteful spending provisions or targeted tax benefits, the President would return to Congress for cancellation individual provisions that would be voted up or down without amendment under expedited legislative procedures. If the Congress were to pass some or all of the President's proposed cancellations, any savings associated with the approved cancellations would be used for deficit reduction and could not be used to offset other spending. Forty-three of the Nation's Governors are authorized to exercise a line-item veto, and the President should be authorized to do the same with respect to Federal Government spending.

Earmark Reforms. The President is also proposing that the Congress continue to make reforms to the earmarking process. Earmarks are provisions in legislation or congressional committee reports that designate a portion of a larger sum of money to be used for a particular purpose, where the recipient or location is named or where the legislation otherwise circumvents a competitive or merit-based process for awarding funds. The number and cost of earmarks have grown dramatically in recent years, more than tripling since the early 1990s. In an effort to bring greater transparency to earmarks, the Administration provides detailed information about these spending provisions at *www.earmarks.omb.gov*. OMB estimates that the number of earmarks grew to over 13,000 in 2005 at a cost of nearly $19 billion. The need for the line-item veto tool was again underscored with the recent congressional action on the 2008 appropriations, which contain more than 11,700 earmarks and other wasteful spending provisions. Last year, the President called on the Congress to provide greater transparency and full disclosure of earmarks by eliminating wasteful earmarks, reducing the number and cost of earmarks by half, and placing earmarks in statutory language rather than report language. The President remains committed to earmark reform and urges the Congress to make earmark reform a top priority for 2008.

Bipartisan Results Commission and Sunset Commission. In addition to proposing a line-item veto and a reduction in earmarks, the President proposes to create bipartisan Results Commissions and a bipartisan Sunset Commission. Results Commissions would propose ways to restructure or consolidate programs or agencies where duplicative or overlapping responsibilities have been identified. If approved by the President, the Results Commissions' proposals would be transmitted to the Congress and considered under expedited legislative procedures. The Sunset Commission would review all Federal agencies and programs on a 10-year schedule and recommend to the President whether the agencies and programs should be continued.

Ensuring an Efficient and Transparent Budget Process

The President is committed to promoting an orderly and transparent budget process. An orderly and efficient budget process would inform the public about the use of their tax dollars and permit Government managers to anticipate likely funding levels for the programs they manage. To bring greater transparency to Federal spending as it is proposed and after it has been spent, the Administration places information on the Internet so it is available to the taxpayer. Such sites include *www.omb.gov* with details of the President's Budget, *www.ExpectMore.gov* with results on how Federal programs are working, *www.results.gov* with scorecards on the performance of Federal agencies, and *www.USAspending.gov* with data showing how Federal dollars were spent.

Joint Budget Resolution. In his Budget, the President is again proposing that the Congress be required to pass each year a joint budget resolution that has the force of law. The current budget resolution that is passed by Congress does not require the President's signature, thereby excluding the President from the early stages of the congressional budget process. Requiring the President's signature on a joint budget resolution would bring the President into the budget process earlier in time and permit the President and the Congress to reach agreement on overall fiscal policy before Congress begins its work on individual tax and spending bills.

Biennial Budgeting. To further improve the efficiency of the budget process, the President is proposing that biennial budgeting be adopted for all Executive Branch agencies. Appropriations legislation would be adopted in odd-numbered years and authorizing legislation would be adopted in even-numbered years. Biennial budgeting would give the Congress and Executive Branch officials more time to devote to program oversight. It would also give Government managers more certainty regarding funding levels, permitting them to devote more time to day-to-day program management and longer-term program planning.

Government Shut-down Prevention. To serve the American taxpayers without interruption, the 2009 Budget proposes to prevent Government shutdowns by allowing funding to occur automatically for those agencies, programs, or accounts for which appropriations bills have not been enacted at the start of the fiscal year. Funding would automatically be provided at the lower of the President's request or the prior year's enacted funding level. This would prevent an interruption in vital services to American taxpayers and prevent the uncertainty and confusion that arises when the Congress does not complete its work on appropriations bills and must instead write last-minute continuing resolutions to keep Government operations running temporarily.