ANALYTICAL PERSPECTIVES

BUDGET OF THE UNITED STATES GOVERNMENT

Fiscal Year 2007

THE BUDGET DOCUMENTS

Budget of the United States Government, Fiscal Year 2007 contains the Budget Message of the President, information on the President's budget and management priorities, and budget overviews organized by agency.

Analytical Perspectives, Budget of the United States Government, Fiscal Year 2007 contains analyses that are designed to highlight specified subject areas or provide other significant presentations of budget data that place the budget in perspective. This volume includes economic and accounting analyses; information on Federal receipts and collections; analyses of Federal spending; detailed information on Federal borrowing and debt; baseline or current services estimates; and other technical presentations.

The *Analytical Perspectives* volume also contains a CD-ROM with several detailed tables previously published in the budget documents, including tables showing the budget by agency and account and by function, subfunction, and program.

Historical Tables, Budget of the United States Government, Fiscal Year 2007 provides data on budget receipts, outlays, surpluses or deficits, Federal debt, and Federal employment over an extended time period, generally from 1940 or earlier to 2007 or 2011. To the extent feasible, the data have been adjusted to provide consistency with the 2007 Budget and to provide comparability over time.

Appendix, Budget of the United States Government, Fiscal Year 2007 contains detailed information on the various appropriations and funds that constitute the budget and is designed primarily for the use of the Appropriations Committees. The *Appendix* contains more detailed financial information on individual programs and appropriation accounts than any of the other budget documents. It includes for each agency: the proposed text of appropriations language, budget schedules for each account, new legislative proposals, explanations of the work to be performed and the funds needed, and proposed general provisions applicable to the appropriations of entire agencies or group of agencies. Information is also provided on certain activities whose outlays are not part of the budget totals.

AUTOMATED SOURCES OF BUDGET INFORMATION

The information contained in these documents is available in electronic format from the following sources:

Budget CD-ROM. The CD-ROM contains all of the budget documents in fully indexed PDF format along with the software required for viewing the documents. The CD-ROM also has many of the budget tables in spreadsheet format. The budget CD-ROM also contains the material on the separate *Analytical Perspectives* CD-ROM.

Internet. All budget documents, including documents that are released at a future date, will be available for downloading in several formats from the Internet. To access these documents use the following address:

www.budget.gov/budget

For more information on access to electronic versions of the budget documents (except CD-ROMs), call (202) 512–1530 in the D.C. area or toll-free (888) 293–6498. To purchase the budget CD-ROM or printed documents call (202) 512–1800.

GENERAL NOTES

1. All years referred to are fiscal years, unless otherwise noted.
2. Detail in this document may not add to the totals due to rounding.
3. At the time of this writing, S. 1932, the Deficit Reduction Act, was pending in the Congress. All references to spending in the Budget assume enactment of S. 1932.

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INTRODUCTION

1. INTRODUCTION

Purpose of This Volume

The *Analytical Perspectives* volume presents analyses that highlight specific subject areas or provide other significant data that place the budget in context. The volume presents crosscutting analyses of Government programs and activities from several perspectives.

Presidential budgets have included separate analytical presentations of this kind for many years. The *1947 Budget* and subsequent budgets included a separate section entitled "Special Analyses and Tables" that covered four or more topics. For the *1952 Budget*, this section was expanded to ten analyses, including many subjects still covered today, such as receipts, investment, credit programs, and aid to State and local governments. With the *1967 Budget* this material became a separate volume entitled "Special Analyses," and included 13 chapters. The material has remained a separate volume since then, with the exception of the Budgets for 1991-1994, when all of the budget material was included in one large volume. Beginning with the *1995 Budget*, the volume has been named *Analytical Perspectives*.

The volume this year continues to reflect an interest in publishing more information on program performance, so that Executive agencies, the Congress, and the public will become increasingly informed about how well programs are performing. Better performance information can help managers improve program effectiveness, and can help Executive and Congressional policymakers improve the allocation of public resources. The performance assessment information is summarized in Chapter 2, "Performance and Management Assessments," and is discussed in many other chapters, especially those in the section, "Crosscutting Programs." One-page summaries of each program assessment are available at *http://www.ExpectMore.gov*.

Again this year, several large tables are included as part of the *Budget* on the enclosed *Analytical Perspectives* CD ROM. A list of the items on the CD ROM is in the Table of Contents of this volume.

Overview of the Chapters

Introduction

1. Introduction. This chapter discusses each chapter briefly and highlights the emphasis on performance in a crosscutting context.

Performance and Management Assessments

2. Budget and Performance Integration. This chapter summarizes the performance and management assessments that have been completed to date using the Program Assessment Rating Tool (PART). One-page summaries of the program evaluations, as well as detail on each of the assessments can be found at *http://www.ExpectMore.gov*.

Crosscutting Programs

3. Homeland Security Funding Analysis. This chapter discusses homeland security funding and provides information on homeland security program requirements, performance, and priorities. Additional detailed information is available on the enclosed *Analytical Perspectives* CD ROM.

4. Strengthening Federal Statistics. This chapter discusses the development of standards that principal statistical programs can use to assess their performance and presents highlights of their 2007 Budget proposals.

5. Research and Development. This chapter presents a crosscutting review of research and development funding in the Budget, including discussions about priorities, performance, and coordination across agencies.

6. Federal Investment. This chapter discusses spending across Federal agencies that yields long-term benefits, and presents information on physical capital, research and development, and education and training. The chapter includes material on the PART assessments related to direct Federal investment spending. There is also a section on capital stocks.

7. Credit and Insurance. This chapter provides crosscutting analyses of the roles and risks of Federal credit and insurance programs and Government-sponsored enterprises (GSEs), as well as criteria for evaluation. It covers the categories of Federal credit (housing, education, business including farm operations, and international) and insurance programs (deposit insurance, pension guarantees, disaster insurance, and insurance against security-related risks). The chapter also includes material on the new President's Management Agenda initiative to improve credit program management. Two detailed tables, "Table 7–10. Direct Loan Transactions of the Federal Government" and "Table 7–11. Guaranteed Loan Transactions of the Federal Government", are on the enclosed *Analytical Perspectives* CD ROM.

8. Aid to State and Local Governments. This discussion presents crosscutting information on Federal grants to State and local governments, including highlights of Administration proposals. The chapter also includes material on the PART assessments related to grants. An Appendix to this chapter includes State-by-State spending estimates of major grant programs.

9. Integrating Services with Information Technology. This chapter presents a crosscutting look at investments in information technology (IT). The chapter describes various aspects of the Administration's information technology agenda, with special emphasis on the performance, efficiency, and effectiveness of the Government's IT investments. Three detailed tables: "Table 9–1. Effectiveness of Agency's IT Management and E-Gov Processes," "Table 9–2. Management Guidance," and "Table 9–3. Status of Presidential E-Government Initiatives," are on the enclosed *Analytical Perspectives* CD ROM.

10. Federal Drug Control Funding. This section presents estimated drug control funding for Federal departments and agencies.

11. California-Federal Bay-Delta Program Budget Crosscut (CALFED). This chapter presents information on Federal and State funding for the California-Federal Bay-Delta Program, in fulfillment of the reporting requirements for this program. Detailed tables on funding and project descriptions are on the enclosed *Analytical Perspectives* CD ROM.

Economic Assumptions and Analyses

12. Economic Assumptions. This discussion reviews recent economic developments; presents the Administration's assessment of the economic outlook, including the expected effects of macroeconomic policies; and compares the economic assumptions on which the Budget is based with the assumptions for last year's budget and those of other forecasters. This chapter also covers topics related to the effects on the budget of changes in economic conditions and assumptions.

13. Stewardship. This chapter assesses the Government's financial condition and sustainability in an integrated framework that includes Federal assets and liabilities; 75-year projections of the Federal budget under alternative assumptions for discretionary spending, health cost, productivity, and demographics; actuarial estimates for the shortfalls in Social Security and Medicare; a national balance sheet that shows the Federal contribution to national wealth; and a table of economic and social indicators. Together these elements serve similar analytical functions to a business's accounting statements.

14. National Income and Product Accounts. This chapter discusses how Federal receipts and outlays fit into the framework of the National Income and Product Accounts (NIPAs) prepared by the Department of Commerce. The NIPA measures are the basis for reporting Federal transactions in the gross domestic product and for analyzing the effect of the budget on aggregate economic activity.

Budget Reform Proposals

15. Budget Reform Proposals. This chapter is a brief description of the Administration's budget reform agenda for addressing the need for responsible budgeting and other reforms.

Federal Borrowing and Debt

16. Federal Borrowing and Debt. This chapter analyzes Federal borrowing and debt and explains the budget estimates. It includes sections on special topics such as the trends in debt, agency debt, investment by Government accounts, and the debt limit.

Federal Receipts and Collections

17. Federal Receipts. This discussion presents information on receipts estimates, enacted tax legislation, and the receipts proposals in the Budget.

18. User Charges and Other Collections. This chapter presents information on receipts from regulatory fees and on collections from market-oriented activities, such as the sale of stamps by the Postal Service, which are recorded as offsets to outlays rather than as Federal receipts.

19. Tax Expenditures. This discussion describes and presents estimates of tax expenditures, which are defined as revenue losses from special exemptions, credits, or other preferences in the tax code. An appendix discusses possible alternatives to the current tax expenditure baselines. This section is prepared by the Department of the Treasury.

Dimensions of the Budget

20. Comparison of Actual to Estimated Totals. This chapter compares the actual receipts, outlays, and deficit for 2005 with the estimates for that year published two years ago in the 2005 Budget. It also includes a historical comparison of the differences between receipts, outlays, and the deficit as originally proposed with final outcomes.

21. Outlays to the Public, Gross and Net. This section provides information on outlays gross and net of offsetting collections and offsetting receipts by agency. Outlays are a measure of Government spending. Offsetting collections and offsetting receipts are netted against gross outlays and result primarily from the Government's business-like activities, such as the sale of stamps by the Postal Service.

22. Trust Funds and Federal Funds. This chapter provides summary information on Federal funds and trust funds, which comprise the entire budget. For trust funds the information includes income, outgo, and balances. Two detailed tables, "Table 22–4. Income, Outgo, and Balances of Major Trust Funds" and "Table 22–5. Income, Outgo, and Balances of Selected Federal Funds" are on the enclosed *Analytical Perspectives* CD ROM.

23. Off-Budget Federal Entities and Non-Budgetary Activities. This chapter discusses off-budget Federal entities (Social Security and Postal Service) and non-budgetary activities (such as cash flows for credit programs, deposit funds, and regulation).

24. Federal Employment and Compensation. This chapter provides summary data on the level and recent trends in civilian and military employment, personnel compensation and benefits, and overseas staffing.

Current Services Estimates

25. Current Services Estimates. This chapter presents estimates, based on rules similar to those contained in the Budget Enforcement Act (BEA), of what receipts, outlays, and the deficit would be if no changes were made to laws already enacted. It discusses the conceptual framework for these estimates and describes differences with the BEA requirements. Two detailed tables, “Table 25–12. Current Services Budget Authority by Function, Category, and Program” and “Table 25–13. Current Services Outlays by Function, Category, and Program”, are on the enclosed *Analytical Perspectives* CD ROM.

Budget System and Concepts

26. The Budget System and Concepts. This is a basic reference to the budget process, concepts, laws, and terminology, and includes a glossary of budget terms.

Other

The following material appears only on the enclosed *Analytical Perspectives* CD ROM:

- *Detailed Functional Tables*. Table 27–1. “Budget Authority and Outlays by Function, Category, and Program”.
- *Federal Programs by Agency and Account*. Table 28–1. “Federal Programs by Agency and Account”.

PERFORMANCE AND MANAGEMENT ASSESSMENTS

2. BUDGET AND PERFORMANCE INTEGRATION

I. INTRODUCTION

The American taxpayer expects the Federal Government to implement programs that will ensure the Nation's security and provide critical services. Taxpayers deserve to have their money spent wisely to create the maximum benefit. The Executive Branch should be held accountable for program performance by the American people. For the Federal Government to be held accountable, the American people must have clear, candid information about each program's success and failures. The Administration is providing this type of information. More importantly, in all cases, the Administration is implementing detailed plans to improve program performance.

The role of the President's Budget and Performance Integration (BPI) Initiative is to ensure that Federal dollars produce the greatest results. To accomplish this, agencies and OMB identify which programs work, which are deficient, and what can be done to improve the performance of them all. In some cases, it may be necessary to reallocate funding to more effective programs. This and other decisions about programs are ultimately made jointly by the Congress and the President, but the analysis of program performance can help the Executive and Legislative Branches make more informed decisions. To expand the use of information about program performance, OMB is launching *ExpectMore.gov*, a user-friendly website that provides the public with performance information about Federal programs. (Greater detail about *ExpectMore.gov* will be provided in a subsequent section.)

The Budget and Performance Integration Initiative measures its success in two principal ways:

- *Improved Program Performance:* Through the use of performance assessments, programs will have the information they need to improve their performance every year. The initiative requires each agency to identify opportunities to improve program management and design, and then develop and implement clear, aggressive plans to get more for tax dollars every year.
- *Greater Investment in Successful Programs:* Overall, scarce resources need to be allocated to programs that benefit the Nation most effectively and efficiently. Program performance will not be the only factor in decisions about how much funding programs receive. However, the Congress and the President, equipped with information about program peformance can consider performance to a greater degree in their decision-making and invest primarily in programs that provide the greatest return on the investment of taxpayer dollars. If poor performing programs are unable to demonstrate improved results, then that investment may be reallocated to programs that can demonstrate greater success.

Currently, the Initiative is showing great progress toward the first goal. Programs are becoming more efficient and more effective through implementation of meaningful improvement plans.

Many programs are demonstrating improved results.

- The Department of Veterans Affairs is reducing the time veterans wait to get medical appointments. From 2001 to 2005, the Veterans Health Administration (VHA) substantially reduced the number of new veteran enrollees unable to schedule an appointment for medical care from a high of 176,000 to 22,494. VHA remains a leader in customer satisfaction, with an inpatient satisfaction score of 84 out of 100 on the American Customer Satisfaction Index, slightly higher than the score of 79 for comparable private sector services.
- To reduce fatalities from automobile accidents, the National Highway Traffic Safety Administration promoted greater seat belt use among high-risk groups such as younger drivers, rural populations, pick-up truck occupants, 8–15 year-old passengers, occasional safety belt users, and motor vehicle occupants in States with secondary safety belt use laws. As a result, nationwide seat belt use increased from 73 percent in 2001 to 82 percent in 2005, an all-time high.

Agencies are also identifying the steps they will take to improve each program's performance even more. All programs, regardless of whether they perform poorly or well, should strive to perform better each year.

Progress toward the second goal of improving resource allocation is slow. Overall high performers received larger funding increases than those that did not perform as well, but in general, recommendations to reduce funding for ineffective programs or those that can not demonstrate results have been less successful.

II. HOW THE BUDGET AND PERFORMANCE INTEGRATION INITIATIVE WORKS

There are several aspects of the Initiative designed to maximize program performance:

- Assess performance with the PART (Program Assessment Rating Tool)

- Publish a Scorecard to hold agencies accountable for managing for results, addressing PART findings, and implementing follow-up actions
- Broadcast results on a new website, *ExpectMore.gov*
- Implement inter-agency program improvement

Comprehensive Assessment by the Program Assessment Rating Tool (PART)

How do we ensure programs are improving every year? First, we assess their current performance. In order to improve program outcomes, it is critical to have a good understanding of how the program is currently performing. To date, we have assessed the performance of 80 percent of all Government programs using the PART.

What is the PART and How is it Used?

The PART helps assess the management and performance of individual programs. With the PART, agencies and OMB evaluate a program's purpose, design, planning, management, results, and accountability to determine its overall effectiveness. Recommendations are then made to improve program results.

To reflect that Federal programs deliver goods and services using different mechanisms, the PART is customized by program type. The seven PART types are: Direct Federal, Competitive Grant, Block/Formula Grant, Research and Development, Capital Assets and Service Acquisition, Credit, and Regulatory. The PART types apply to both discretionary and mandatory programs. *ExpectMore.gov* also classifies each program by its specific program area (such as environment, transportation, education, etc) so we can accelerate the improved performance of programs with similar missions.

Each PART includes 25 basic questions and there are additional questions tailored to different program types. The questions are divided into four sections. The first section of questions gauges whether a program has a clear purpose and is well designed to achieve its objectives. The second section evaluates strategic planning, and weighs whether the agency establishes outcome-oriented annual and long-term goals for its programs. The third section rates the management of an agency's program, including the quality of efforts to improve efficiency. The fourth section assesses the results programs can report with accuracy and consistency.

The answers to questions in each of the four sections result in a numerical score for each section from 0 to 100 (100 being the best score). Because reporting a single weighted numerical rating could suggest false precision, or draw attention away from the very areas most in need of improvement, numerical scores are combined and translated into qualitative ratings. The bands and associated ratings are as follows:

Rating	Range
Effective	85–100
Moderately Effective	70–84
Adequate	50–69
Ineffective	0–49

Regardless of overall score, programs that do not have acceptable performance measures or have not yet collected performance data generally receive a rating of "Results Not Demonstrated." This rating suggests that not enough information and data are available to make an informed determination about whether a program is achieving results.

PART ratings do not result in automatic decisions about funding. Clearly, over time, funding should be targeted to programs that can prove they achieve measurable results. In some cases, a PART rating of "Ineffective" or "Results Not Demonstrated" may suggest that greater funding is necessary to overcome identified shortcomings, while a funding decrease may be proposed for a program rated "Effective" if it is not a priority or has completed its mission. However, most of the time, an "Effective" rating is an indication that the program is using its funding well and that major changes are not needed.

Publish a Scorecard To Hold Agencies Accountable

Agencies are achieving greater results with the help of the habits and discipline established through the Budget and Performance Integration Initiative (BPI). These agencies recognize that the PART can be a useful tool to drive the agencies to improved performance.

The President's Management Agenda established clear, Government-wide goals or Standards for Success (*http://results.gov/agenda/standards.pdf*) for several key areas, one of which is Budget and Performance Integration. Agencies have developed and are implementing detailed, aggressive action plans to achieve these goals. Most importantly, agencies are held publicly accountable for adopting these disciplines. The Standards for Success for the BPI Initiative are below:

- Meets quarterly with senior agency managers to examine reports that integrate financial and performance information that covers all major responsibilities of the Department. Agency achieves planned improvements in program performance and efficiency in achieving results each year;
- Develops strategic plans that contain a limited number of outcome-oriented goals and objectives. Annual budget and performance documents incorporate measures identified in the PART and focus on the information used in the senior management report described in the first criterion;
- Demonstrates that it has performance appraisal and awards systems for all Senior Executive Service (SES) and managers, and more than 60 percent of the workforce, that effectively: link to agency mission, goals, and outcomes; hold employees accountable for results appropriate for their level of responsibility; differentiate between various levels of performance (i.e., multiple performance levels with at least one summary rating above Fully Successful); and provide consequences based on performance. In addition, at a beta site, there is evidence that clear expectations are communicated to employees; rating and awards data demonstrate that managers effectively planned, monitored, developed and appraised employee performance; and the site is ready to link pay to the performance appraisal systems. The agency is working to include all agency employees under such systems;
- Reports the full cost of achieving performance goals accurately in budget and performance documents and can accurately estimate the marginal cost of changing performance goals;
- Has at least one efficiency measure for all PARTed programs; and
- Uses PART evaluations to direct program improvements, and PART ratings and performance information are used consistently to justify funding requests, management actions, and legislative proposals. Less than 10 percent of agency programs receive a Results Not Demonstrated rating for two years in a row.

Each quarter, agencies received two ratings. First, they are rated on their status in achieving the overall goals for each initiative. They are then given a green, yellow or red rating to clearly announce their performance. Green status is for success in achieving each of the criteria listed earlier; yellow is for an intermediate level of performance; and red is for unsatisfactory results.

Second, agency progress toward reaching the Budget and Performance Integration standards is assessed separately. This is reviewed on a case by case basis against the work plan and related time lines established for each agency. Progress is also given a color rating. Green is given when implementation is proceeding according to plans agreed upon with the agencies; Yellow for when some slippage or other issues require adjustment by the agency in order to achieve the initiative objectives on a timely basis; and Red when the Initiative is in serious jeopardy. In this case, it is unlikely to realize objectives absent significant management intervention.

As of December 31, 2005, nine agencies achieved green status on the Budget and Performance Integration Initiative Scorecard. The agencies at green are:

1. Department of Energy
2. Department of Labor
3. Department of Transportation
4. Department of State
5. National Aeronautics and Space Administration
6. National Science Foundation
7. Small Business Administration
8. Social Security Administration
9. U.S. Agency for International Development

The Scorecard is an effective accountability tool to ensure agencies manage the performance of their programs. Although a scorecard rating is not directly linked to any specific consequences, it is quickly understood at the highest levels of the Administration as an indicator of an agency's strength or weakness.

The Government-wide scorecard reporting on individual agency progress is published quarterly at *http://results.gov/agenda/scorecard.html.*

Broadcast Results on ExpectMore.gov

This year, a new website, *ExpectMore.gov*, will provide Americans with candid information about which programs work, which do not, and what all programs are doing to get better every year.

Up until now, Americans have had limited access to information on how the Federal Government performs. In many cases, the Federal Government performs well. In some cases, it performs better than the private sector.

This site will contain PART summaries for all programs that have been assessed to date. The site will provide the program information a concerned citizen would need to assess a program's performance. Each assessment includes a brief description of the program's purpose, its overall rating, some highlights about its performance and the steps it will take to improve in the future. For those interested in more information, there are links to the detailed program assessment, as well as that program's website and the assessment summaries of other similar programs. The detailed PART assessment includes the answer to each PART question with an explanation and supporting evidence. It also includes the performance measures for the program along with current performance information. In addition, there is an update on the status of follow-up actions to improve program performance.

A visitor to the site may find, at least initially, programs are not performing as well as they should or program improvement plans are not sufficiently ambitious. We expect this site to change that. The website will have a variety of benefits. It will:

- Increase public attention to performance;
- Draw greater scrutiny to agency action (or inaction) to improve program results:
  —Improvement plans will be transparent
  —Statements about goals and achievements will be clearer; and
- Create demand for better quality and more timely performance data.

Implement Inter-Agency Program Improvement

The Administration continues to look for new ways to improve the performance of programs with similar purpose or design by using the PART to analyze performance across agencies (i.e., cross-cutting analysis). Cross-cutting analysis can improve coordination and communication by getting managers from multiple agencies to agree to a common set of goals and placing the focus on quantifiable results. This type of analysis breaks down barriers across the Federal, State, and local levels so all are working toward the same goal. Only topics that are expected to yield meaningful results are selected for cross-cutting analyses. This past year the Administration completed cross-cutting analyses of block grant programs, Small Business Innovation Research, and credit programs.

Block Grants. One of the most common tools used by the Federal Government is the block grant, particularly in the social services area where States and localities oftentimes award grants to local service providers. Block grants are embraced for their flexibility to meet local needs and criticized because accountability for results can be difficult when funds are allocated based on formulas and population counts rather than achievements or needs. In addition, block grants pose performance measurement challenges precisely because they can be used for a wide range of activities. The obstacles to measuring and achieving results through block grants are reflected in PART scores: they receive the second lowest average score of the seven PART types: 8 percent of block grant programs assessed to date are rated ineffective, and 45 percent are results not demonstrated.

The characteristics that distinguish high performing block grant programs from low performing ones are:

- Top management is committed to managing for results;

- Strong, outcome-oriented performance measures and goals are used by management and grantees;
- Performance information is relevant, transparent and accessible so management and grantees can easily find out what works and replicate it
- Program performance is incorporated into managers' and employees' performance appraisals.

The goal of this cross-cutting analysis was to share best practices for block grant programs across agencies. During this past year, the BPI Initiative led a seminar where multiple agencies learned lessons about performance measurement, accountability, data collection, and reporting for block grants.

All block grant programs will integrate the lessons from this work into aggressive improvement plans that ensure:

- Grantees and subgrantees strive to achieve outcome-oriented goals;
- Data on whether those goals are achieved are collected and made public; and
- Information about proven interventions and how to implement them is shared widely.

The long term impact of this work will be visible over the coming years as we monitor the ability of these programs to create better outcomes for the citizens they serve.

Small Business Innovation Research (SBIR). The SBIR program sets aside 2.5 percent of Government research and development contract and grant funding for small businesses. The goal of the program is to assist small businesses in undertaking and obtaining the benefits of research and development leading to commercial products, while assisting agencies in achieving their missions. Approximately $2 billion was spent last year in SBIR programs.

All Federal agencies with Research and Development budgets above $100 million per year must publish a list of technical topics that they would like to support, after which small businesses are encouraged to submit research funding proposals addressing opportunities in those areas. First, agencies provide winning companies seed funding to explore the feasibility of their projects and, if deemed promising after initial investigation, funding is provided for subsequent research and development. Awards generally are limited to less than $1 million per project. Agencies monitor the progress of the selected projects and report key data annually to the Small Business Administration.

A team, consisting of agency and OMB representatives, is carrying out the following activities:

- Assessing the program's impact;
- Focusing on improving program administration;
- Determining if legislative reform is needed;
- Developing common long-term and annual measures; and
- Developing a database that tracks commercialization and sales in a consistent manner.

Credit Programs. The Federal Government is one of the world's largest lenders. At the end of 2003, the Government held a financial asset portfolio of nearly $1.5 trillion, including direct loans, loan guarantees, defaulted loans, and non-credit debt owed to agencies. Many agencies lack the data, processes, or overall understanding of the credit lifecycle (origination, loan servicing/lender monitoring, liquidation, and debt collection) needed to effectively assist intended borrowers while also proactively reducing errors, risk, and cost to the Government. Some credit program PART scores reflect these fundamental inefficiencies. More information about the performance of credit programs is available in chapter 7 in this volume.

The Budget and Performance Integration initiative identified the "back office" function of the five largest credit agencies (Agriculture, Education, Housing and Urban Development, Small Business Administration, and Veterans Administration) and Treasury as an appropriate target for analysis. The Deputy Director for Management created a Council to address improvements in these back office functions. The Federal Credit Council convened its first meeting in March 2005.

In order to create accountability in credit programs, the President's Management Agenda scorecard has been expanded to include a set of standards for credit program management. The standards include criteria for red, yellow and green status related to:

- loan origination;
- servicing and/or lender monitoring; and
- debt collection.

The first scorecard will be published subsequent to the President's 2007 Budget, with quarterly scorecard reports describing individual agencies' milestones for addressing weaknesses.

Many agencies lack the systems and data to conduct regular analysis consistent with minimum private sector standards, resulting in larger than anticipated losses to the Government. For example, institution of early warning systems to identify high-risk borrowers and provide targeted intervention at agencies currently without such systems could reduce defaults substantially, given the size of agency portfolios. The Council is working to improve compliance with the provision of the Debt Collection Improvement Act that bars certain borrowers through increased reporting to, and use of, private credit bureaus. This permits better identification of delinquent Federal debtors and avoids extending additional credit to poor credit risks. Savings to the Government are expected to be up to $100 million per year.

The Council has substantially completed the Sharing Lender Performance Data (SLPD) portal that allows comparison of private lenders' default and delinquency rates, and other portfolio data, across agencies. This will result in better decisions to approve lender participation in programs, provide benchmarks for ranking lenders, and could provide an additional monitoring tool to reduce borrower defaults through early action.

Initiatives of the Council aim to improve management functions and have the potential to reduce delinquent debt by up to $10 billion, in addition to substantial cost savings on the front end in the form of reduced administrative and subsidy cost expenses.

Community and Economic Development Programs. The Federal Government spends more than $16 billion annually to support local economic and community development. In 2004, agencies and OMB participated in a crosscutting review of the 35 Federal programs that make up this effort. Based on PART analyses, input from agencies, and other program information, the team identified common problems that reduced the effectiveness of this Federal spending. They concluded that the programs, taken together, were duplicative, not well-targeted, and in many cases lacked clear goals, and a system to measure community progress and evaluate program impacts.

Last year's budget proposed to consolidate 18 of the programs (which spend about $4.8 billion) in a new Strengthening America's Communities Initiative. For 2007, the Administration re-proposes program consolidation—this time in HUD and Commerce. The consolidation will be accompanied by three major reforms to make more effective use of these resources by: 1) better targeting funds to places that lack the means to create conditions for economic progress, 2) consolidating overlapping and/or ineffective programs into flexible grants that include rewards for community progress and results, and 3) coordinating the full set of Federal economic and community development programs within a common framework of goals, standards, and outcome measures.

III. RESULTS

As mentioned above, the BPI Initiative measures its success according to two measures:

- Improved Program Performance; and
- Greater Investment in Successful Programs

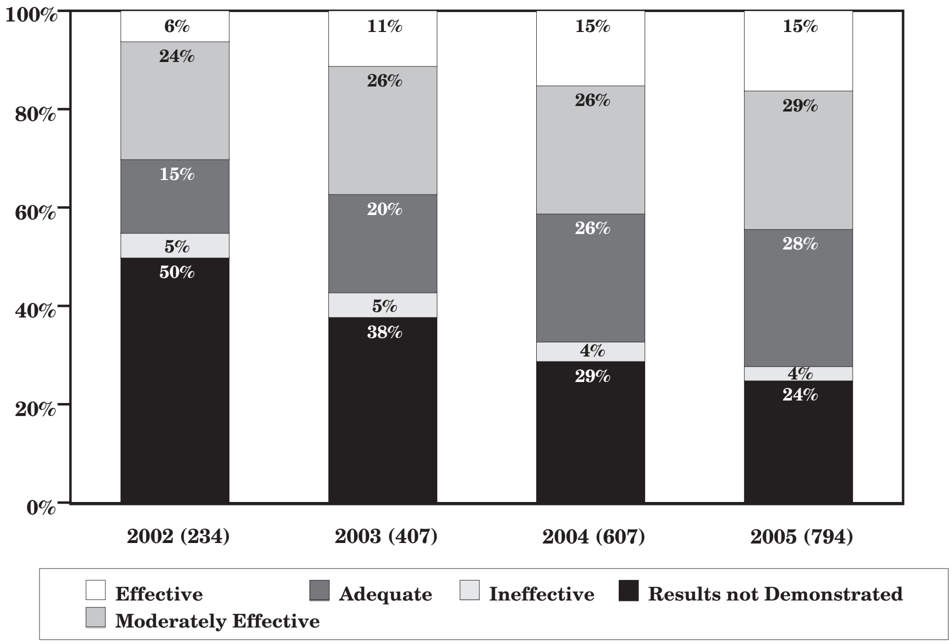
There has been a good deal of success toward achieving goals of the first measure. The BPI Initiative has caused agencies to think more systematically about how they measure and improve program performance. Though there are many factors that impact program performance, it is clear that the BPI Initiative has framed the discussion around results. Agencies have developed ways to measure their efficiency so they can figure out how to do more with Americans' tax dollars.

This marks the fourth year that the PART was used to (1) assess program performance, (2) take steps to improve program performance, and (3) help link performance to budget decisions. To date, the Administration has assessed 794 programs, which represent approximately 80 percent of the Federal budget. Over the next year, the Administration will use the PART to assess the performance and management of most of the remaining Federal programs.

With the help of the PART, we have improved program performance and transparency. There has been a substantial increase in the total number of programs rated either "Effective", "Moderately Effective", or "Adequate". This increase came from both re-assessments and newly PARTed programs. The chart below shows the percentage of programs by ratings category.

Chart 2-1. Program Ratings are Improving

Cumulative Program Results by Rating Category (2002-2005)



The results demonstrate that the BPI initiative is having success focusing Agencies' attention on program performance. For example, approximately:

- 1 in 7 programs has improved its PART rating;
- Half of programs rated Results Not Demonstrated have improved their ratings;
- 80 percent of programs have acceptable performance measures;
- 40 percent have achieved their long-term goals and 60 percent have achieved their annual goals; and
- 80 percent of programs have efficiency measures and about half of them have achieved their efficiency targets.

Unfortunately, there has not been a similar level of accomplishment in the second measure: Greater Investment in Successful Programs. Though use of performance information has been limited, most in the Congress are aware of the PART. This topic was discussed extensively in a Government Accountability Office (GAO) report issued last year.

GAO recommends that OMB select PART reassessments and crosscutting reviews based on factors including the relative priorities, costs, and risks associated with clusters of related programs, and reflective of congressional input. Additionally, GAO recommended OMB solicit congressional views on the performance issues and program areas most in need of review; the most useful performance data and the presentation of those data. As mentioned above, OMB is using the PART to improve the performance of similar programs in areas that are expected to yield meaningful results. OMB and agencies are also actively soliciting the views of the Congress in PART assessments, on improvement plans, and oversight efforts.

IV. NEXT STEPS

The BPI Initiative has identified several activities to improve its effectiveness over the coming year:

Ensure Plans are Aggressive and Result in Improved Performance.—Rigorous follow-up on recommendations from the PART will accelerate improvements in the performance of Federal programs. This will ensure that the hard work done through the PART produces performance and management improvements. Additionally, implementation of these plans must be tracked and reported.

Expand Cross-Cutting Analyses.—Use the PART to facilitate cross-cutting analysis where there is a higher return than approaching programs individually. The goal of these efforts is to increase efficiency and save dollars. We want to continue to build on the success of previous cross-cuts. Congressional guidance will be a factor in choosing topics for the next group of cross-cutting analyses.

Maximize ExpectMore.gov Impact.—The Federal Government should be accountable to the public for its performance. This new web-based tool will provide candid information on how programs are performing and what they are doing to improve. The BPI Initiative will work to increase the reach and impact of this valuable information to improve program performance and accountability for results.

Note.—A table with summary information for all programs that have been reviewed using the Program Assessment Rating Tool (PART) is available at *http://www.whitehouse.gov/omb/budget/fy2007/sheets/part.pdf* This table provides program ratings, section scores, funding levels, and other information.

CROSSCUTTING PROGRAMS

3. HOMELAND SECURITY FUNDING ANALYSIS

Since the terrorist attacks of September 11, 2001, the Federal Government, with State, local and private sector partners, has engaged in a broad, determined effort to thwart terrorism, identifying and pursuing terrorists abroad and implementing an array of measures to secure our citizens and resources at home. The Administration has worked with the Congress to reorganize the Federal Government; acquire countermeasures to biological weapons; enhance security at our borders, transportation sites and critical infrastructures; and strengthen America's preparedness and response capabilities in our cities and local communities. Elements of our national homeland security strategy—to prevent terrorist attacks within the United States, reduce America's vulnerability to terrorism, and minimize the damage from attacks that may occur—involve every level of government as well as the private sector and individual citizens. Since September 11th, homeland security has continued to be a major policy focus for all levels of government, and one of the President's highest priorities.

To underscore the importance of homeland security as a crosscutting Government-wide function, section 889 of the Homeland Security Act of 2002 requires a homeland security funding analysis to be incorporated in the President's Budget. This analysis addresses that legislative requirement. It covers the homeland security funding and activities of all Federal agencies, not only those carried out by the Department of Homeland Security (DHS), and discusses State, local, and private sector expenditures. In addition, not all activities carried out by DHS constitute homeland security funding (e.g., response to natural disasters, Coast Guard search and rescue activities), so DHS estimates in this section do not represent the entire DHS budget.

Federal Expenditures

The Federal spending estimates in this analysis utilize funding and programmatic information collected on the Executive Branch's homeland security efforts.[1] Throughout the budget formulation process, the Office of Management and Budget (OMB) collects three-year funding estimates and associated programmatic information from all Federal agencies with homeland security responsibilities. These estimates do not include the efforts of the Legislative or Judicial branches. Information in this chapter is augmented by a detailed appendix of account-level funding estimates, which is available on the *Analytical Perspectives* CD ROM.

To compile this data, agencies report information using standardized definitions for homeland security. The data provided by the agencies are developed at the "activity level," which is a set of like programs or projects, at a level of detail sufficient to consolidate the information to determine total Governmental spending on homeland security.

To the extent possible, this analysis maintains programmatic and funding consistency with previous estimates. Some discrepancies from data reported in earlier years arise due to agencies' improved ability to extract terrorism-related activities from host programs and refine their characterizations. As in the Budget, where appropriate, the data is also updated to reflect agency activities, Congressional action, and technical re-estimates. In addition, the Administration may refine definitions or mission area estimates over time based on additional analysis or changes in the way specific activities are characterized, aggregated, or disaggregated. For example, this year's budget includes significant re-estimates for the homeland security funding requested in two agencies' budgets: the U.S. Coast Guard, and the Department of Defense. When changes in the way agencies estimate homeland security expenditures are made, they are reflected in all years in order to maintain consistency.

In the case of the Coast Guard, the agency derives its homeland security funding estimates using an activity-based costing model to allocate its budget among its various missions. In early fiscal year 2005, the Coast Guard discovered the assumptions for this model had not been updated to reflect post-9/11 mission demands, meaning the projections derived from the model were increasingly inconsistent with actual, post-9/11 spending. After reviewing several years of post-9/11 performance data, the Coast Guard updated its modeling assumptions to better reflect its current mission execution. In addition, as part of its annual government-wide review of homeland security activities, OMB determined that the Coast Guard was reporting both its "Drug Interdiction" and "International Fisheries Enforcement" activities as homeland security programs, which was inconsistent with the Government-wide definition of homeland security activities. As a result, these two mission activities have been dropped from the homeland security data.

The revisions to the Department of Defense (DOD) homeland security funding estimates also better reflect actual spending by the Department. Previously, the DOD homeland security funding estimates were derived from an annual report issued by the DOD Comptroller's office that identified funding spent on combating terrorism activities. Now, DOD has been able to identify discrete, homeland security-related projects, programs

[1] All data in the Federal expenditures section are based on the President's policy for the 2007 Budget. Additional policy and baseline data is presented in the "Additional Tables" section. Due to rounding, data in this section may not add to totals in other Budget volumes.

and activities within the budget accounts of the various service branches. As a result, the funding estimates are more precise and integrated with the DOD budget.

The following table reflects the adjustments made for the Coast Guard and DOD re-estimates:

	FY 2005 Effect	FY 2006 Effect [2]
DoD Re-Estimate	+7,541	+7,992
Coast Guard Re-Estimate	–940	–790

[2] The 2006 adjustments reflect comparisons between the 2006 requested levels and the revised 2006 enacted levels. As a result, a small amount of the adjustment is attributable to differences between the 2006 Budget and the 2006 enacted funding levels, not just technical re-estimates.

Total funding for homeland security has grown significantly since the attacks of September 11, 2001. For 2007, the President's Budget includes $58.3 billion for homeland security activities, a $3.4 billion (6.3 percent) increase over the 2006 level. Excluding mandatory funding and the Department of Defense, the 2007 Budget proposes a gross discretionary increase of $3 billion (8.2 percent) over the 2006 level. The Budget also proposes to increase aviation security fees to allow the Government to recover more of its core security costs of Federal aviation screening operations. Including this fee proposal, the net non-defense discretionary increase from 2006 to 2007 is 3.3 percent.

Table 3–1. HOMELAND SECURITY FUNDING BY AGENCY

(Budget authority, in millions of dollars)

Budget Authority	2005 Enacted	2005 Supplemental	2006 Enacted	2006 Supplemental	2007 Request
Department of Agriculture	595.9	....	563.0	....	650.3
Department of Commerce	166.7	....	181.1	....	217.8
Department of Defense	16,107.7	1,080.2	16,440.4	....	16,697.8
Department of Education	23.9	....	27.5	....	25.8
Department of Energy	1,562.0	....	1,705.2	....	1,699.6
Department of Health and Human Services	4,229.4	....	4,299.1	0.1	4,563.3
Department of Homeland Security	23,979.9	569.2	25,499.0	176.9	27,777.0
Department of Housing and Urban Development	2.0	....	1.9	....	1.9
Department of the Interior	65.0	....	55.6	....	55.4
Department of Justice	2,690.8	76.1	2,975.4	16.1	3,279.8
Department of Labor	56.1	....	48.3	....	58.7
Department of State	824.1	....	1,107.9	....	1,212.5
Department of Transportation	219.3	....	181.0	....	206.0
Department of the Treasury	101.1	0.4	115.8	....	133.4
Department of Veterans Affairs	249.4	....	308.8	....	313.4
Corps of Engineers	89.0	....	72.0	....	43.0
Environmental Protection Agency	106.3	....	129.3	....	183.3
Executive Office of the President	29.5	....	20.8	....	24.6
General Services Administration	65.2	....	98.6	....	95.9
National Aeronautics and Space Administration	220.5	....	212.6	....	203.7
National Science Foundation	342.2	....	344.2	....	387.4
Office of Personnel Management	3.0	....	2.7	....	2.8
Social Security Administration	154.7	....	176.8	....	183.8
District of Columbia	15.0	....	13.5	....	9.0
Federal Communications Commission	1.8	....	2.3	....	5.4
Intelligence Community Management Account	72.4	....	56.0	....	55.0
National Archives and Records Administration	17.1	....	18.2	....	18.1
Nuclear Regulatory Commission	59.2	....	79.3	....	70.3
Postal Service	503.0	....	....	....	....
Securities and Exchange Commission	5.0	....	5.0	....	5.0
Smithsonian Institution	75.0	....	83.7	....	80.4
United States Holocaust Memorial Museum	8.0	....	7.8	....	7.8
Corporation for National and Community Service	17.0	....	20.4	....	14.9
Total, Homeland Security Budget Authority	**52,657.2**	**1,725.8**	**54,852.9**	**193.1**	**58,282.9**
Less Department of Defense	–16,107.7	–1,080.2	–16,440.4	....	–16,697.8
Non-Def. Homeland Security Budget Authority excluding BioShield	**36,549.5**	**645.6**	**38,412.6**	**193.1**	**41,585.1**
Less Fee-Funded Homeland Security Programs	–3,444.1	....	–4,130.0	....	–6,022.0
Less Mandatory Homeland Security Programs	–2,193.6	....	–2,232.0	....	–2,454.1
Net Non-Defense Discretionary, Homeland Security Budget Authority excluding BioShield	**30,911.8**	**645.6**	**32,050.6**	**193.1**	**33,109.0**
Plus BioShield	2,508.0	....	....	....	....
Net Non-Defense Discretionary, Homeland Security Budget Authority including BioShield	**33,419.8**	**645.6**	**32,050.6**	**193.1**	**33,109.0**
Obligations Limitations					
Department of Transportation Obligations Limitation	78.2	....	121.0	....	99.7

A total of 32 agencies comprise Federal homeland security funding in 2007. Of those, five agencies—the Departments of Homeland Security (DHS), Defense (DOD), Health and Human Services (HHS), Justice (DOJ) and Energy (DOE)—account for approximately 93 percent of total Government-wide homeland security funding in 2007.

The growth in Federal homeland security funding is indicative of the efforts that have been initiated to secure our Nation. However, it should be recognized that fully developing the strategic capacity to protect America is a complex effort. There is a wide range of potential threats and risks from terrorism. To optimize limited resources and minimize the potential social costs to our free and open society, homeland security activities should be prioritized based on the highest threats and risks. Homeland security represents a partnership among the Federal Government, State and local governments, the private sector, and individual citizens, each with a unique role in protecting our Nation.

The *National Strategy for Homeland Security* provides a framework for addressing these challenges. It guides the highest priority requirements for securing the Nation. As demonstrated below, the Federal Government has used the *National Strategy* to guide its homeland security efforts. For this analysis, agencies categorize their funding data based on the critical mission areas defined in the National Strategy for Homeland Security: intelligence and warning, border and transportation security, domestic counterterrorism, protecting critical infrastructures and key assets, defending against catastrophic threats, and emergency preparedness and response. In all tables, classified funding controlled by the Director of National Intelligence is combined with the Department of Defense and titled "Department of Defense."

The *National Strategy* is a dynamic document. It includes actions that agencies use and must build upon to measure progress. In some cases, progress may be easily measured. In others, Federal agencies, along with State and local governments and the private sector, are working together to develop measurable goals. Finally, in some areas, Federal agencies and partners must continue to develop a better understanding of risks and threats—such as the biological agents most likely to be used by a terrorist group or the highest-risk critical infrastructure targets—in order to develop benchmarks.

Funding presented in this report is analyzed in the context of major "mission areas." Activities in many of the mission areas are closely related. For example, information gleaned from activities in the intelligence and warning category may be utilized to inform law enforcement activities in the domestic counterterrorism category. Augmentation of pharmaceutical stockpiles categorized as emergency preparedness and response, may address agents that represent catastrophic threats.

This chapter highlights some significant results from OMB's Performance Assessment Rating Tool (PART), as well as some major performance metrics and milestones. These are not an exhaustive list of homeland security PART results, measures, or milestones; nor are they exempt from the performance measurement challenges highlighted above. However, they do illustrate the Government's efforts to build a better framework to measure homeland security performance.

The following table summarizes funding levels by the *National Strategy's* mission areas; more detailed analysis is provided in subsequent mission-specific analysis sections.

Table 3–2. HOMELAND SECURITY FUNDING BY NATIONAL STRATEGY MISSION AREA

(Budget authority, in millions of dollars)

Agency	2005 Enacted	2005 Supplemental	2006 Enacted	2006 Supplemental	2007 Request
Intelligence and Warning	349.8	....	428.2	....	604.4
Border and Transportation Security	16,652.3	386.2	18,348.6	159.6	20,177.1
Domestic Counterterrorism	3,974.5	257.3	4,548.0	17.6	4,661.6
Protecting Critical Infrastructure and Key Assets	17,835.9	849.4	17,851.7	....	18,350.6
Defending Against Catastrophic Threats	8,146.4	142.8	8,639.8	0.5	8,882.1
Emergency Preparedness and Response	5,654.5	90.1	4,924.3	15.4	5,474.9
Other	43.8	....	112.4	....	132.2
Total, Homeland Security Budget Authority	**52,657.2**	**1,725.8**	**54,852.9**	**193.1**	**58,282.9**
Plus BioShield	2,508.0	....	....	....	....
Total, Homeland Security Budget Authority , including BioShield	**55,165.2**	**1,725.8**	**54,852.9**	**193.1**	**58,282.9**

National Strategy Mission Area: Intelligence and Warning

The intelligence and warning mission area covers activities to detect terrorist threats and disseminate terrorist-threat information. The category includes intelligence collection, risk analysis, and threat-vulnerability integration activities for preventing terrorist attacks. It also includes information sharing activities among Federal, State, and local governments, relevant private sector entities, and the public at large. It does not include most foreign intelligence collection—although the resulting intelligence may inform homeland security activities—nor does it fully capture classified intelligence activities. In 2007, funding for intelligence and warning is distributed between DHS (61 percent), primarily in the Office of Intelligence and Analysis; DOJ (26 percent), primarily in the Federal Bureau of Investigation (FBI); and other Intelligence Community members (13 percent). The 2007 funding for intelligence and warning activities is 41 percent above the 2006 level.

Table 3–3. INTELLIGENCE AND WARNING FUNDING

(Budget authority, in millions of dollars)

Agency	2005 Enacted	2005 Supplemental	2006 Enacted	2006 Supplemental	2007 Request
Department of Agriculture	6.3	......	6.7	......	22.3
Department of Homeland Security	226.4	......	323.3	......	370.4
Department of Justice	44.2	......	41.7	......	156.2
Department of the Treasury	0.6	......	0.6	......	0.6
Intelligence Community Management Account	72.4	......	56.0	......	55.0
Total, Intelligence and Warning	**349.8**	......	**428.2**	......	**604.4**

The major requirements addressed in the intelligence and warning mission area include:

- Unifying and enhancing intelligence and analytical capabilities to ensure officials have the information they need to prevent attacks; and
- Implementing information sharing and warning mechanisms, such as the Homeland Security Advisory System, to allow Federal, State, local, and private authorities to take action to prevent attacks and protect potential targets.

As established by the Intelligence Reform and Terrorism Prevention Act of 2004, the Director of National Intelligence (DNI) is ensuring that his newly established office is setting collection and analysis priorities that are consistent with the new National Intelligence Strategy. This new strategy calls for the integration of both the domestic and foreign dimensions of U.S. intelligence so that there are no gaps in our understanding of threats to the homeland. The DNI is also ensuring that information sharing takes place in an environment where access to terrorism information is matched to the roles, responsibilities, and missions of all the organizations across the intelligence community. These changes allow the intelligence community to "connect the dots" more effectively, develop a better integrated system for identifying and analyzing terrorist threats, and issue warnings more rapidly.

The National Counterterrorism Center (NCTC) is specifically chartered to centralize U.S. Government terrorism threat analysis and ensure that all agencies receive relevant analysis and information. NCTC serves as the primary organization in the U.S. Government for analyzing and integrating all intelligence pertaining to terrorism and counterterrorism (except purely domestic terrorism) and the central and shared knowledge bank on known and suspected terrorists and international terror groups. It also ensures that agencies, as appropriate, have access to and receive the all-source intelligence support needed to execute their counterterrorism plans or perform independent, alternative analysis. NCTC is tasked to coordinate counterterrorism operations on a global basis and develop strategic, operational plans for the Global War on Terrorism.

The DNI and the NCTC work to utilize the unique assets and capabilities of other Government agencies—some of which are reorganizing to improve these capabilities and better interface with the new intelligence structure. As such, the NCTC allocates requirements to the agencies with the assets and capabilities to address them. In addition, NCTC has formed a new core staff of analysts drawn from multiple intelligence agencies. This variety ensures that NCTC can access the Intelligence Community's full breadth of knowledge and complement the activities of individual agencies. Despite the addition of this new permanent planning staff, NCTC will not undertake direct operations but will continue to leave mission execution with the appropriate agencies. This separation ensures that the chain of command remains intact and prevents potential bureaucratic micromanagement of counterterrorism missions. Taken together, the creation of the NCTC and recent legislation and executive orders will ensure counterterrorism assets are better allocated and more tightly coordinated to produce improved indications and warning intelligence to benefit homeland security.

The 2007 request for FBI supports improvements in its intelligence infrastructure to enable the Bureau to leverage its workforce, particularly the agents, intelligence analysts, and support staff in the newly-created National Security Branch. The National Security Branch will integrate the Intelligence Directorate with the Counterterrorism and Counterintelligence Divisions to ensure that FBI activities are coordinated with other Intelligence Community agencies under the Director of National Intelligence's leadership.

Over the past four years, the FBI has developed its intelligence capabilities and improved its ability to protect the American people from threats to national security. It has built on its established capacity to collect information and enhanced its ability to analyze and disseminate intelligence. The President's 2007 Budget supports the FBI's priorities and its continuing transformation by providing the resources needed for its intelligence operations and modernization of its operations. These initiatives will increase the number of secure facilities for conducting intelligence analysis; enhance intelligence collection, systems, and training; continue development of the FBI's new case management system that will reduce paperwork and improve information sharing; and upgrade fingerprint identification systems to improve screening activities to identify potential terrorists.

As a result of the Department of Homeland Security's 2005 re-organization, a new Office of Intelligence and Analysis (OIA) was established to strengthen intelligence functions and information sharing within DHS. OIA gathers information to analyze terrorist threats to critical infrastructure, transportation systems, or other targets inside the homeland. Led by the newly-created DHS Chief Intelligence Officer reporting directly to the Secretary, this office not only relies on its own analysts (comprised of personnel from the former Information Analysis and Infrastructure Protection Directorate), but draws on the expertise of other DHS components with information collection and analytical capabilities. For example, improved coordination and information sharing between border agents, air marshals, and intelligence analysts deepens the Department's understanding of terrorist threats. By maintaining and expanding its partnership with the NCTC, DHS will better coordinate its activities with other members within the intelligence community and the DNI. The Office also serves as the focal point for disseminating information to states and local entities. For example, OIA is connected to homeland security directors of States and territories through the Homeland Security Information Network (HSIN). All fifty States and major urban areas are connected to HSIN, and HSIN is now being rolled out to major counties as well.

National Strategy Mission Area: Border and Transportation Security

This mission area covers activities to protect border and transportation systems, such as screening airport passengers, detecting dangerous materials at ports overseas and at U.S. ports-of-entry, and patrolling our coasts and the land between ports-of-entry. The majority of funding in this mission area ($18.8 billion, or 93 percent, in 2007) is in DHS, largely for the U.S. Customs and Border Protection (CBP), the Transportation Security Administration (TSA), and the Coast Guard. Other DHS bureaus and other Departments, such as State and Justice, also play a significant role. The President's 2007 request would increase funding for border and transportation security activities by 10 percent over the 2006 level.

Securing our borders and transportation systems is a complex task. Security enhancements in one area may make another avenue more attractive to terrorists. Therefore, our border and transportation security strategy aims to make the U.S. borders "smarter"—targeting resources toward the highest risks and sharing information so that frontline personnel can stay ahead of potential adversaries—while facilitating the flow of legitimate visitors and commerce. The creation of DHS, which unified the Federal Government's major border and transportation security resources, facilitates the integration of risk targeting systems and ensures greater accountability in border and transportation security. Rather than having separate systems for managing goods, people, and agricultural products, one agency is now accountable for ensuring that there is one cohesive border management system.

Since 2001, the Administration and Congress have increased funding for border security by 93 percent and immigration enforcement by 90 percent. The Administration continues to deploy new technology—from unmanned aircraft to ground sensors to infrared cameras; and has eliminated the barriers that prevented DHS from completing a 14-mile border fence running along the border south of San Diego. The 2007 Budget provides funding for 1,500 new border patrol agents and new technology, including portable imaging machines, cameras, sensors and automated targeting systems that focus on high-risk travelers and goods. This investment will support smarter and more secure borders.

To ensure detention and removal of illegal aliens present in the United States, the Budget provides $2.1 billion, a $626 million increase over 2006, to support detention and removal efforts. This includes funding to expand the program to apprehend alien fugitives and to increase efforts to ensure that aliens convicted of crimes in the United States are deported directly from correctional institutions after their time is served. The Budget provides funding to add more than 6,000 new detention beds to hold illegal immigrants while they await removal. This will bring the total number of beds available to approximately 27,500. DHS will also make improvements in processing and deporting

Table 3–4. BORDER AND TRANSPORTATION SECURITY FUNDING

(Budget authority, in millions of dollars)

Agency	2005 Enacted	2005 Supplemental	2006 Enacted	2006 Supplemental	2007 Request
Department of Agriculture	159.1	....	165.3	....	164.9
Department of Homeland Security	15,628.7	386.2	17,078.6	159.6	18,820.9
Department of Justice	34.5	....	30.4	....	20.5
Department of State	778.5	....	1,056.6	....	1,152.1
Department of Transportation	51.5	....	17.7	....	18.7
Total, Border and Transportation Security	**16,652.3**	**386.2**	**18,348.6**	**159.6**	**20,177.1**

aliens, cutting the time of detention for aliens in half from 30 days to 15 days. A 2003 PART found this program moderately effective because DHS Immigration and Customs Enforcement (ICE) has reorganized its operations and engaged in significant strategic and performance planning efforts to identify ambitious goals to improve program performance.

DHS is leading the interagency effort to implement a coordinated approach to terrorist-related screening in immigration, law enforcement, intelligence, counterintelligence, border and transportation systems, and critical infrastructure, covering areas from information sharing to screener training. Key to the Federal Government's screening of international visitors is the US-VISIT program, which is designed to expedite the clearance of legitimate travelers while identifying and denying clearance to those who may intend harm. Through 2005, the first phases of US-VISIT were successfully deployed. US-VISIT currently collects two digital fingerprints and a digital photograph. The ability to screen visitors against criminal and terrorist information as well as confirming the identity of travelers has improved border security. However, in the future, to improve accuracy in the identification of visitors, first-time visitors to the United States will be enrolled in the program by submitting 10 fingerprints, allowing the identification of visitors with even greater accuracy. DHS, in conjunction with the Departments of State and Justice, is in the process of implementing this multi-year project to improve screening, and the 2007 Budget includes: a $60 million increase for DHS for 10-print deployment and for interoperability with the FBI's fingerprint system, the Integrated Automated Fingerprint Identification System (IAFIS); a $71 million increase for FBI to upgrade IAFIS; and $10 million for the Department of State to begin implementing these new security measures.

In the area of aviation security, the Administration continues to enhance the multiple levels of security implemented in the wake of the September 11th attacks. The Transportation Security Administration (TSA) has made significant improvements in aviation security since 9/11 by implementing a layered, risk-based security approach. These advances include hardened cockpit doors, a greatly expanded Federal Air Marshals program, arming some pilots through the Federal Flight Deck Officers program, offering voluntary self defense training to crew members, and screening 100 percent of passenger and checked baggage. TSA will further strengthen these efforts in 2007 by requesting $4.6 billion for aviation screening operations, an increase of $74 million, which ensures sufficient resources for Transportation Security Officer staffing at our Nation's airports. Combined with the funds provided in 2006, TSA will apply over $100 million to enhance air cargo security over the next two years. TSA will also commit over $690 million to the purchase, installation, and maintenance of baggage screening devices, including in-line systems that will increase baggage throughput up to 250 percent. The Budget also provides over $80 million for emerging technology at passenger checkpoints. This technology will enhance the detection of prohibited items, especially firearms and explosives, through the use of additional sensors such as whole body imaging, automated explosive sampling, and cast and prosthesis scanners. The Budget also proposes to cover about 70 percent of core aviation security costs through aviation security fees.

The safeguarding of our seaports is critical since terrorists may seek to use them to enter the country or introduce weapons or other dangerous materials. With 95 percent of all U.S. cargo passing through the Nation's 361 ports, a terrorist attack on a major seaport could slow the movement of goods and be economically devastating. The Maritime Transportation Security Act (MTSA) and its implementing regulations, issued by DHS in October 2003, require ports, vessels, and facilities to conduct security assessments. In 2007, the Coast Guard will continue to ensure compliance with MTSA port and vessel security standards and regulations. The 2007 Budget provides more than $2 billion for port security across DHS, primarily for Coast Guard port security activities such as Maritime Safety and Security Teams and harbor patrols. In addition, the Coast Guard's budget funds operations to strengthen intelligence collection and surveillance capabilities in the maritime environment, both of which contribute to the broader Coast Guard effort to enhance Maritime Domain Awareness. In addition, ports are among the infrastructure assets protected through DHS Targeted Infrastructure Protection (TIP) grants, which fall under the Infrastructure Protection mission area.

The State Department Bureau of Consular Affairs is the second largest contributor to border and transportation security. The State Border Security program includes visa, passport, American Citizen Services and International Adoption programs. In 2007, the State Department will work through the interagency process to achieve full and real-time interoperability between biographic and biometric screening systems for 10 fingerprint collection from foreign travelers, as part of the US-VISIT Program.

In addition, the Department of State will also lead the implementation of the Western Hemisphere Travel Initiative in 2007, which mandates that all travelers within the Western Hemisphere travel with a passport or other authorized document by 2009. Under this initiative, United States citizens and foreign visitors traveling to and from the Caribbean, Bermuda, Panama, Canada or Mexico will be required to have a passport or standardized travel card that establishes the bearer's identity and nationality to enter or re-enter the United States. The initiative will improve security at our borders by standardizing entry and exit information and increasing the ability of Government agencies to work together.

In 2007, the State Department plans to increase staff to create a dedicated team focused on inter-country adoptions and preventing and resolving cases of international parental child abduction.

National Strategy Mission Area: Domestic Counterterrorism

Funding in the domestic counterterrorism mission area covers Federal and Federally-supported efforts to identify, thwart, and prosecute terrorists in the United States. The largest contributors to the domestic counterterrorism mission are law enforcement organizations: the Department of Justice (largely for the FBI) and DHS (largely for ICE), accounting for 53 and 44 percent of funding for 2007, respectively. The President's 2007 request would increase funding for domestic counterterrorism activities by 2.5 percent over the 2006 level.

Table 3–5. DOMESTIC COUNTERRORISM FUNDING

(Budget authority, in millions of dollars)

Agency	2005 Enacted	2005 Supplemental	2006 Enacted	2006 Supplemental	2007 Request
Department of Homeland Security	1,897.0	183.0	2,132.8	2.0	2,070.8
Department of Justice	1,999.0	74.3	2,325.3	15.6	2,482.7
Department of Transportation	20.0	....	21.0	....	21.0
Department of the Treasury	54.9	....	64.8	....	82.5
Social Security Administration	3.7	....	4.2	....	4.6
Total, Domestic Counterterrorism	**3,974.5**	**257.3**	**4,548.0**	**17.6**	**4,661.6**

Since the attacks of September 11th, preventing and interdicting terrorist activity within the United States has become a priority for law enforcement at all levels of government. The major requirements addressed in the domestic counterterrorism mission area include:

- Developing a proactive law enforcement capability to prevent terrorist attacks;
- Apprehending potential terrorists; and
- Improving law enforcement cooperation and information sharing to enhance domestic counterterrorism efforts across all levels of government.

The President's 2007 Budget supports the FBI's top strategic priority: to protect the United States from terrorist attacks. FBI continues to build its counterterrorism capabilities post-9/11. Over the past five years, FBI has shifted resources to counterterrorism from lower priority programs, hired and trained additional field investigators, and strengthened headquarters oversight of the counterterrorism program. More recently, FBI has taken a major step toward integration of counterterrorism, counterintelligence, and intelligence functions by establishing the new National Security Branch to oversee all three programs. Overall, FBI resources in the domestic counterterrorism category have increased from $0.9 billion in 2002 to $1.9 billion in 2007, with the 2007 Budget providing an increase of more than $200 million over the 2006 level. One of the largest 2007 initiatives for enhancing counterterrorism capabilities is $100 million for Sentinel, the FBI's new automated case management system, which will streamline record-keeping and facilitate sharing of information about terrorists.

By merging existing immigration and customs enforcement functions into ICE, the Department of Homeland Security created one of America's largest law enforcement agencies. The Nation is better prepared to apprehend potential terrorists because DHS has combined the information and resources to identify and investigate illegal activities—such as smuggling, identity theft, and money laundering, and trafficking in dangerous materials. The 2004 PART found that the investigative arm of ICE, the Office of Investigations, has made significant progress in the integration of former customs and immigration investigators, and has started to reap the benefits of additional investigative authorities. However, the program must institute stronger financial and management controls to ensure appropriate expenditure and budgeting of resources and to hold managers and agency partners accountable for performance results. The 2007 Budget provides an increase of $127 million for these enforcement activities.

National Strategy Mission Area: Protecting Critical Infrastructure and Key Assets

Funding in the protecting critical infrastructure and key assets mission area captures the efforts of the U.S. Government to secure the Nation's infrastructure, including information infrastructure, from terrorist attacks. Protecting the Nation's key assets is a complex challenge because of the diversity of infrastructures and since it is estimated that more than 85 percent of the Nation's key assets are privately owned. DOD reports the largest share of funding in this category for 2007 ($11.3 billion, or 62 percent), and includes programs focusing on physical security and improving the military's ability to prevent or mitigate the consequences of attacks against departmental personnel and facilities. DHS has overall responsibility for prioritizing and executing infrastructure protection activities at a national level and accounts for $2.9 billion (16 percent) of 2007 funding. In addition, a total of 25 other agencies report funding to protect their own assets and work with States, localities, and the private sector to reduce vulnerabilities in their areas of expertise. The President's 2007 request increases funding for activities to protect critical infrastructure and key assets by $499 million (2.8 percent) over the 2006 level.

Securing America's critical infrastructure and key assets is a complex task. The major requirements include:

- Unifying disparate efforts to protect critical infrastructure across the Federal Government, and with State, local, and private stakeholders;
- Building and maintaining a complete and accurate assessment of America's critical infrastructure and key assets and prioritizing protective action based on risk;
- Enabling effective partnerships to protect critical infrastructure; and
- Reducing threats and vulnerabilities in cyberspace.

Table 3–6. PROTECTING CRITICAL INFRASTRUCTURE AND KEY ASSETS FUNDING

(Budget authority, in millions of dollars)

Agency	2005 Enacted	2005 Supplemental	2006 Enacted	2006 Supplemental	2007 Request
Department of Agriculture	150.7	.....	93.2	.....	46.0
Department of Defense	10,838.2	847.8	11,096.8	.....	11,304.3
Department of Energy	1,456.1	.....	1,523.7	.....	1,503.6
Department of Health and Human Services	168.2	.....	181.7	.....	188.8
Department of Homeland Security	2,580.9	.....	2,678.5	.....	2,898.0
Department of Justice	468.8	1.3	521.1	.....	568.3
Department of Transportation	137.0	.....	132.5	.....	154.0
Department of Veterans Affairs	212.8	.....	273.5	.....	271.2
National Aeronautics and Space Administration	220.5	.....	212.6	.....	203.7
National Science Foundation	315.2	.....	317.2	.....	359.4
Social Security Administration	150.6	.....	172.0	.....	178.5
Postal Service	503.0	.....	.....	.....	.....
Other Agencies	633.9	0.4	649.2	.....	675.0
Total, Protecting Critical Infrastructure and Key Assets	**17,835.9**	**849.4**	**17,851.7**	.....	**18,350.6**

Homeland Security Policy Directive 7 (HSPD-7), signed in December 2003, established a national policy to protect critical infrastructures and key resources from attack, ensure the delivery of essential goods and services, and maintain public safety and security. Under HSPD-7, DHS is responsible for managing Federal critical infrastructure protection efforts. To provide the overall framework to integrate various critical infrastructure protection activities, DHS has developed the interim National Infrastructure Protection Plan. Under the plan's risk-management approach, DHS will coordinate the infrastructure protection programs of other Federal departments and agencies.

Recognizing that each infrastructure sector possesses it own unique characteristics, the National Infrastructure Protection Plan designates a sector-specific agency to oversee infrastructure protection efforts for each sector. This approach enables agencies to rely on specialized expertise and long-standing relationships with industry in conducting infrastructure protection activities. With the National Infrastructure Protection Plan, sector-specific agencies are pursuing infrastructure protection efforts in concert with DHS. There are 13 critical infrastructure sectors and 9 sector-specific agencies, including DHS, to cover them. For example, the Budget provides $10 million to DHS to improve security at chemical plant sites. The Environmental Protection Agency is seeking $38 million in 2007 to expand its Water Sentinel program to four more cities. The program develops pilot systems for cost effective, early detection of disease, pest, or poisonous agents in drinking water systems. To protect agricultural resources, the Department of Agriculture has undertaken the responsibility to identify critical agricultural assets throughout the country. They have completed extensive physical security assessments to make sure that all agricultural physical security issues throughout the United States are in line with latest polices and regulations. The Department of Energy continues to coordinate protection activities within the energy sector. Overall, additional enhancements are being provided for 14 agencies to perform critical infrastructure protection activities that are essential to the success of the National Infrastructure Protection Plan.

In addition to developing the National Infrastructure Protection Plan, DHS recently reorganized its infrastructure protection programs and created a new Preparedness Directorate in order to better focus preparedness activities on objective measures of risk and performance. The new Directorate is responsible for both physical and cyber infrastructure protection. The Office of Infrastructure Protection, located within the new Preparedness Directorate, is responsible for managing and prioritizing infrastructure protection at a national level. The Office operates the National Asset Database, which catalogues critical infrastructure and key assets. The data collected within the database is used to identify the most critical infrastructure, assess vulnerabilities, and enable DHS to develop a risk-based strategy to protect them. DHS conducts site visits and assessments at various sites each year, and has used this information to develop site security guidelines for nuclear power plants and chemical facilities. Security guidelines are also being developed for other infrastructure sectors. DHS also trains State and local officials and infrastructure owners to improve security in the areas immediately surrounding critical sites. The 2007 Budget provides $462 million for these activities in the protecting critical infrastructures and key assets mission area. In conjunction with funding for the Office of Infrastructure Protection, the Administration proposes $600 million for Targeted Infrastructure Protection (TIP) grants, which will integrate existing disparate grant programs for securing transportation assets and other critical infrastructures. Awarded through the Preparedness Directorate's Office of Grants and Training, TIP grants and assistance will supplement State and local infrastructure protection efforts, especially detection and security investments.

Cyberspace security is a key element of infrastructure protection because the internet and other computer systems link infrastructure sectors. The consequences of a cyber attack could cascade across the economy, imperiling public safety and national security. To address this threat, DHS established the National Cyber Security Division (NCSD) in 2003, in response to the President's *National Strategy to Secure Cyberspace*, in order to identify, analyze and reduce cyber threats and vulnerabilities, coordinate incident response, and provide technical assistance. NCSD, now part of DHS' Preparedness Directorate, works collaboratively with public, private, and international entities to secure cyberspace and America's cyber assets. For example, it coordinated the response and mitigation of the Sober and Zotob computer viruses. NCSD has also established the U.S. Computer Emergency Response Team (US-CERT), which operates a cyber watch, warning, and incident response center. US-CERT supports a watch and warning capability responsible for tracking incident and trend data, ranking associated severity, and generating real-time alerts.

NCSD also operates a Control Systems Security Program. Today, many critical infrastructures such as pipelines, water and pumping stations, and pharmaceutical production are run by control systems. These systems make our critical infrastructure assets more automated, more productive, more efficient, and more innovative, but they also may expose many of those physical assets to cyber-related threats and vulnerabilities. NCSD works to address these weaknesses and enhance control systems security. To evaluate readiness and response programs such as the National Response Plan, NCSD conducts national cyber exercises such as Cyber Storm with public and private sector entities. These exercises test our capabilities and improve our ability to respond to an incident. To support these critical preparedness activities, the Budget includes $93 million for the NCSD in 2007. The Budget also includes an increase of $6 million for research and development on new technologies to enhance cyber security that will be conducted by the Science and Technology Directorate.

National Strategy Mission Area: Defending Against Catastrophic Threats

The defending against catastrophic threats mission area covers activities to research, develop, and deploy technologies, systems, and medical measures to detect and counter the threat of chemical, biological, radiological, and nuclear (CBRN) weapons. The agencies with the most significant resources to help develop and field technologies to counter CBRN threats are DOD ($5.0 billion, or 56 percent, of the 2007 total), HHS ($2.0 billion, or 22 percent, of the 2007 total), largely for research at the National Institutes of Health, and DHS, mostly for the Directorate of Science and Technology (S&T) ($1.3 billion, or 15 percent, of the 2007 total). The President's 2007 request would increase funding for activities to defend against catastrophic threats by 2.8 percent over the 2006 level.

The major requirements addressed in this mission area include:

- Preventing terrorist use of CBRN weapons through detection systems and procedures, and improving decontamination techniques; and

Table 3–7. DEFENDING AGAINST CATASTROPHIC THREATS FUNDING

(Budget authority, in millions of dollars)

Agency	2005 Enacted	2005 Supplemental	2006 Enacted	2006 Supplemental	2007 Request
Department of Agriculture	222.7	.....	238.3	.....	342.7
Department of Commerce	73.4	.....	80.6	.....	83.4
Department of Defense	4,925.4	142.4	5,004.3	.....	4,986.4
Department of Energy	7.5	.....	62.1	.....	58.9
Department of Health and Human Services	1,901.8	.....	1,856.3	.....	1,976.0
Department of Homeland Security	936.1	.....	1,306.1	.....	1,338.6
Department of Justice	33.5	0.5	37.4	0.5	42.3
Department of the Treasury	.....	.....	.....	.....	0.9
National Science Foundation	27.0	.....	27.0	.....	28.0
Nuclear Regulatory Commission	19.0	.....	27.8	.....	24.9
Total, Defending Against Catastrophic Threats	**8,146.4**	**142.8**	**8,639.8**	**0.5**	**8,882.1**

- Developing countermeasures, such as vaccines and other drugs to protect the public from the threat of a CBRN attack or other public health emergency.

DOD defends the nation against catastrophic threats by undertaking long-term research on chemical and biological threats and by developing strategies to counter the risk of such attacks. DOD's efforts in maritime defense and interdiction provide early detection and response to possible CBRN threats. DOD also conducts anti-terrorism planning to defend against a potential CBRN or other terrorist attack against a military base or installment. Finally, the U.S. Northern Command, the military command responsible for homeland defense, is included in this category.

To protect against a nuclear or radiological weapon entering the country, the Domestic Nuclear Detection Office (DNDO), created in 2006 within the Department of Homeland Security, will coordinate the Nation's nuclear detection efforts. The DNDO is responsible for developing and deploying a comprehensive system to detect and report any attempt to import a nuclear explosive device or radiological material into the United States. This Office has oversight of all research and development for detection, identification, and reporting of radiological and nuclear materials. It is also responsible for establishing response protocols to ensure that the detection of a nuclear explosive device or radiological material leads to timely and effective action by military, law enforcement, emergency response, and other appropriate Government assets. The 2007 Budget includes $536 million for the DNDO, a 70-percent increase from the 2006 level. Together with the Departments of State, Energy, Defense, and Justice, the DNDO is deploying a comprehensive system to detect and report any attempt to import, assemble, or transport a nuclear device, fissile or radiological materials within the United States.

In 2007, DNDO will conduct $100 million in transformational research and development aimed at enhancing our ability to detect, identify, and attribute nuclear and radiological materials. This research looks beyond current capabilities and seeks to find new scientific tools and methodologies that may prove useful in broad efforts to focus the Nation's resources toward countering the threat of nuclear and radiological devices. The DNDO budget also includes $178 million for the deployment of both fixed and mobile radiation portal monitors at strategic points of entry throughout the country. Together with overseas non-proliferation efforts led by the Department of State, and overseas detection capabilities managed by the Department of Energy, these programs seek to create a seamless approach toward preventing terrorists anywhere in the world from acquiring, transporting, or introducing these materials into the United States.

Another key element in addressing these requirements is developing and maintaining adequate countermeasures for a CBRN attack. This not only means stockpiling countermeasures that are currently available, but developing new countermeasures for agents that currently have none, and next-generation countermeasures that are safer and more effective than those that presently exist. Also, unlike an attack with conventional weapons, a CBRN attack may not be immediately apparent. Working to ensure earlier detection and characterization of an attack helps protect and save lives.

The Budget continues to invest in efforts to decrease the time between an attack and implementation of Federal, State and local response protocols. The Science and Technology Directorate will expand and enhance the BioWatch environmental monitoring program, which samples and analyzes air in over 30 metropolitan areas to continually check for dangerous biological agents. The program is designed to provide early warning of a large-scale biological weapon attack, thereby allowing the distribution of life-saving treatment and preventative measures before the development of serious and widespread illnesses.

The Administration continues HHS' investment in developing medical countermeasures to CBRN threats, investing nearly $2 billion, an increase of $120 million over 2006 and $1.9 billion over the level prior to September 11th (this includes funding for programs focused on chemical and radiological and nuclear countermeasures referenced below). For 2007, the Budget includes nearly $160 million at NIH for the advanced development of medical countermeasures against threats of bioterrorism. Large investments in basic research of medical countermeasures through NIH have helped create multiple promising products to protect the public against the threat of a terrorist attack. These investments will accelerate the development of these products to help Project BioShield acquire them more quickly for inclusion in the Strategic National Stockpile.

HHS will continue to improve human health surveillance with over $100 million dedicated to the BioSense program (collecting information from hospitals, emergency departments, and laboratories to identify "real-time" trends), increasing laboratory capacity, and augmenting the number and quality of border health and quarantine stations. FDA and USDA will also conduct surveillance to ensure the security of the food supply. Information collected from these programs will be disseminated to the National Biosurveillance Integration Center at DHS.

National Strategy Mission Area: Emergency Preparedness and Response

The Emergency Preparedness and Response mission area covers agency efforts to prepare for and minimize the damage from major incidents and disasters, particularly terrorist attacks that endanger lives and property or disrupt Government operations. The mission area encompasses a broad range of agency incident management activities, as well as grants and other assistance to States and localities. Response to natural disasters, including catastrophic natural events such as Hurricane Katrina, does not fall within the definition of a homeland security activity. However, in preparing for terrorism-related threats, many of the activities within this mission area also support preparedness for catastrophic natural disasters. Additionally, lessons learned from the response to Hurricane Katrina will help to revise and strengthen catastrophic response planning.

Table 3–8. EMERGENCY PREPAREDNESS AND RESPONSE FUNDING

(Budget authority, in millions of dollars)

Agency	2005 Enacted	2005 Supplemental	2006 Enacted	2006 Supplemental	2007 Request
Department of Defense	344.2	90.1	339.4	....	407.0
Department of Energy	98.4	....	119.4	....	137.1
Department of Health and Human Services	2,159.4	....	2,261.2	0.1	2,398.5
Department of Homeland Security	2,671.8	....	1,868.9	15.3	2,147.9
Other Agencies	380.7	....	335.5	....	384.4
Total, Emergency Preparedness and Response	**5,654.5**	**90.1**	**4,924.3**	**15.4**	**5,474.9**
Plus BioShield	2,508.0	....	....	....	....
Total, Emergency Preparedness and Response including BioShield	**8,162.5**	**90.1**	**4,924.3**	**15.4**	**5,474.9**

HHS, the largest contributor ($2.4 billion, or 44 percent, in 2007), assists States, localities and hospitals to upgrade public health capacity and maintains a national stockpile of medicines and vaccines for use following an event. DHS maintains the second largest share of funding in this category ($2.1 billion, or 39 percent, for 2007), mainly for preparedness grant assistance to State and local first responders. A total of 23 other agencies include emergency preparedness and response funding. A number of agencies maintain specialized response assets that may be called upon in select circumstances, and others report only funding for their agency's internal preparedness capability. In the President's 2007 Budget, funding for emergency preparedness and response activities would increase by $551 billion (11 percent) over the 2006 level. The major requirements addressed in this mission area include:

- Establishing measurable goals for national preparedness and ensuring that Federal funding supports these goals;
- Ensuring that Federal programs to train and equip States and localities meet national preparedness goals in a coordinated and complementary manner;
- Encouraging standardization and interoperability of first responder equipment, especially for communications;
- Building a national training, exercise, and evaluation system;
- Implementing the National Incident Management System;
- Preparing health care providers for a mass casualty event; and
- Augmenting America's pharmaceutical and vaccine stockpiles.

Many of the key elements of the national emergency response system are already in place. During 2004, separate Federal response plans were integrated into a single all-discipline National Response Plan. The recent release of a unified National Preparedness Goal provides a new framework for guiding Federal, State, and local investments. In order to ensure that these investments translate into improvements in preparedness, we must continue to identify capability gaps and improve response and recovery efforts at all levels of government. A related challenge is ensuring that investments in State and local preparedness are focused on building new response capabilities, and not simply supplanting normal operating expenses. DHS is leading an interagency effort to better match Federal resources with achieving national preparedness goals.

From 2001 through 2006, the Federal Government has allocated $22.5 billion in State and local terrorism preparedness grant funding from the Departments of Homeland Security, Health and Human Services, and Justice, increasing spending from an annual level of approximately $350 million in 2001 to $4 billion in the 2007 request. The funding growth has been directed to Federal assistance for State and local preparedness and response activities, including equipping and training first responders and preparing the public health infrastructure for a range of terrorist threats. The Federal Government has also taken steps to rationalize and simplify the distribution of State and local assistance; better target funds based on risks, threats, vulnerability and need; and develop and implement the eight national priorities and 37 target capabilities identified in the new National Preparedness Goal.

In 2005, DHS rolled-out the National Response Plan, and the Administration is currently reviewing the plan to include lessons learned from the response to Hurricane Katrina. DHS will provide grant funding to support approximately 200 terrorism preparedness exercises in 2006 and 2007, and take an active role in organizing the 2007 Top Officials (TOPOFF) exercise. The 2007 Budget continues to provide coordinated terrorism preparedness training and equipment for State and local responders across the various responder agencies. The 2007 request includes $2.1 billion for terrorism preparedness grants, training, and exercises to be administered by the Preparedness Directorate within DHS, and proposes to continue current progress on restructuring in the grant allocation process to better address threats and needs. The Budget also supports a range of Federal response capabilities, including providing $110 million for the Department of Energy's Nuclear Emergency Support Team, $20 million within DHS for the Federal Emergency Management Agency's Urban Search and Rescue teams, and other emergency response, management, and operations assets. The capabilities of these teams range from providing radiological assistance in support of State and local agencies to responding to major incidents worldwide. The Budget also includes more than $100 million in DHS and HHS to strengthen the Nation's capabilities to respond to a mass casualty event.

The Administration continues making significant investments in medical countermeasures through Project BioShield. BioShield is designed to stimulate the development of the next generation of countermeasures by allowing the Federal Government to buy critically needed vaccines and medications for biodefense as soon as experts agree they are safe and effective enough to be added to the Strategic National Stockpile. This program provides an incentive to manufacture these countermeasures. BioShield is a shared responsibility, joining the intelligence capabilities of DHS with the medical expertise of HHS.

The Budget includes $594 million to maintain and augment this supply of vaccines and other countermeasures that can be made available within 12 hours in the event of a terrorist attack or other public health emergency. This includes funding for storage and maintenance of products purchased through BioShield, and nearly $50 million for the purchase of supplies under the medical surge capacity initiative. HHS has the lead role in preparing public health providers for catastrophic terrorism. For 2007, HHS will provide nearly $475 million to continue improvements for hospital infrastructure and mutual aid through the Health Resources and Services Administration, and $824 million for States through the Centers for Disease Control and Prevention for upgrades to State and local public health capacity. This investment will bring the total assistance provided by HHS to States, local governments and health care providers since 2001 to nearly $8.5 billion.

Non-Federal Expenditures [3]

State and local governments and private-sector firms also have devoted resources of their own to the task of defending against terrorist threats. Some of the additional spending has been of a one-time nature, such as investment in new security equipment and infrastructure; some additional spending has been ongoing, such as hiring more personnel, and increasing overtime for existing security personnel. In many cases, own-source spending has supplemented the resources provided by the Federal Government.

Many governments and businesses continue to place a high priority on and provide additional resources for security. On the other hand, many entities have not increased their spending. A 2004 survey conducted by the National Association of Counties found that as a result of the homeland security process of intergovernmental planning and funding, three out of four counties believed they were better prepared to respond to terrorist threats. Moreover, almost 40 percent of the surveyed counties had appropriated their own funds to assist with homeland security. Own-source resources supplemented funds provided by States and the Federal Government. However, the same survey revealed that 54 percent of counties had not used any of their own funds. [4]

There is also a diversity of responses in the businesses community. A 2003 survey conducted by the Conference Board showed that just over half of the companies reported that they had permanently increased security spending post-September 11, 2001. About 15 percent of the companies surveyed had increased their security spending by 20 percent or more. Large increases in spending were especially evident in critical industries, such as transportation, energy, financial services, media and telecommunications, information technology, and healthcare. However, about one-third of the surveyed companies reported that they had not increased their security spending after September 11th. [5] Given the difficulty of obtaining survey results that are representative of the entire universe of States, localities, and businesses, it is expected that there will be a wide range of estimates on non-Federal security spending for critical infrastructure protection.

Additional Tables

The tables in the Federal expenditures section above present data based on the President's policy for the 2007 Budget. The tables below present additional policy and baseline data, as directed by the Homeland Security Act of 2002.

[3] OMB does not collect detailed homeland security expenditure data from State, local, or private entities directly.

[4] Source: National Association of Counties, "Homeland Security Funding—2003 State Homeland Security Grants Programs I and II."

[5] Source: Conference Board, "Corporate Security Management" 2003.

Estimates by Agency:

Table 3–9. DISCRETIONARY FEE-FUNDED HOMELAND SECURITY ACTIVITIES BY AGENCY

(Budget authority, in millions of dollars)

Agency	2005 Enacted	2005 Supplemental	2006 Enacted	2006 Supplemental	2007 Request
Department of Energy	1.2	....	1.9	....	2.0
Department of Homeland Security	2,404.0	....	2,788.0	....	4,578.0
Department of State	763.3	....	988.4	....	1,128.8
General Services Administration	58.6	....	91.8	....	88.4
Social Security Administration	151.0	....	173.4	....	179.2
Federal Communications Commission	1.8	....	2.3	....	5.4
Nuclear Regulatory Commission	59.2	....	79.3	....	35.2
Securities and Exchange Commission	5.0	....	5.0	....	5.0
Total, Discretionary Homeland Security Fee-Funded Activities	**3,444.1**	....	**4,130.0**	....	**6,022.0**

Table 3–10. MANDATORY HOMELAND SECURITY FUNDING BY AGENCY

(Budget authority, in millions of dollars)

Agency	2005 Enacted	2005 Supplemental	2006 Enacted	2006 Supplemental	2007 Request
Department of Agriculture	131.0	....	137.1	....	139.1
Department of Commerce	12.1	....	14.1	....	28.7
Department of Energy	11.0	....	12.0	....	13.0
Department of Health and Human Services	14.2	....	16.6	....	16.6
Department of Homeland Security	2,022.7	....	2,048.3	....	2,248.2
Department of Labor	2.6	....	3.9	....	8.6
Total, Homeland Security Mandatory Programs	**2,193.6**	....	**2,232.0**	....	**2,454.1**

Table 3–11. BASELINE ESTIMATES—TOTAL HOMELAND SECURITY FUNDING BY AGENCY

(Budget authority, in millions of dollars)

Agency	2006 Enacted*	Baseline				
		2007	2008	2009	2010	2011
Department of Agriculture	564	579	593	609	623	639
Department of Commerce	181	200	1,173	194	200	205
Department of Defense	16,441	16,857	17,343	17,836	18,341	18,868
Department of Education	28	28	29	29	30	30
Department of Energy	1,704	1,743	1,770	1,809	1,848	1,889
Department of Health and Human Services	4,300	4,401	4,508	4,612	4,715	4,825
Department of Homeland Security*	25,503	26,565	27,449	28,291	29,152	30,046
Department of Housing and Urban Development	2	2	2	2	2	3
Department of the Interior	56	57	61	62	66	68
Department of Justice	2,976	3,092	3,205	3,320	3,437	3,561
Department of Labor	48	53	49	51	51	52
Department of State	1,107	1,131	1,157	1,180	1,205	1,230
Department of Transportation	182	190	197	205	212	222
Department of the Treasury	117	120	123	130	134	137
Department of Veterans Affairs	310	318	326	334	340	349
Corps of Engineers	72	74	75	77	78	80
Environmental Protection Agency	129	133	136	141	144	148
Executive Office of the President	21	21	22	22	23	23
General Services Administration	99	100	104	104	108	109
National Aeronautics and Space Administration	213	218	222	228	232	236
National Science Foundation	344	351	359	367	374	383
Office of Personnel Management	3	3	3	3	3	3
Social Security Administration	177	181	185	189	194	196
District of Columbia	14	14	15	15	15	16
Federal Communications Commission	2	5	5	5	5	5
Intelligence Community Management Account	56	57	58	60	61	62
National Archives and Records Administration	18	18	19	19	20	20
Nuclear Regulatory Commission	79	82	85	89	91	94
Securities and Exchange Commission	5	5	5	5	5	6
Smithsonian Institution	83	87	90	96	100	103
United States Holocaust Memorial Museum	8	8	8	8	9	9
Corporation for National and Community Service	20	20	21	21	21	22
Total, Homeland Security Budget Authority	**54,862**	**56,713**	**59,397**	**60,113**	**61,839**	**63,639**
Less Department of Defense	–16,441	–16,857	–17,343	–17,836	–18,341	–18,868
Non-Defense Discretionary Homeland Security Budget Authority, excluding BioShield	**38,421**	**39,856**	**42,054**	**42,277**	**43,498**	**44,771**
Less Fee-Funded Homeland Security Programs	–4,127	–4,255	–4,350	–4,441	–4,537	–4,630
Less Mandatory Homeland Security Programs	–2,232	–2,455	–3,543	–2,650	–2,733	–2,820
Net Non-Defense Discretionary Homeland Security Budget Authority excluding BioShield	**32,062**	**33,146**	**34,161**	**35,186**	**36,228**	**37,321**
Plus BioShield	....	....	....	2,175	....	....
Net Non-Defense Discretionary Homeland Security Budget Authority including BioShield	**32,062**	**33,146**	**34,161**	**37,361**	**36,228**	**37,321**
Obligations Limitations						
Department of Transportation Obligations Limitation	121	124	126	130	131	135

* FY 2006 Enacted estimates exclude supplemental appropriations.

Estimates by Budget Function:

Table 3–12. HOMELAND SECURITY FUNDING BY BUDGET FUNCTION

(budget authority, in millions of dollars)

Agency	2005 Enacted *	2006 Enacted **	2007 Request
National Defense	20,581	20,771	20,430
International Affairs	824	1,107	1,213
General Science Space and Technology	619	616	655
Energy	102	124	125
Natural Resources and the Environment	288	285	316
Agriculture	578	541	611
Commerce and Housing Credit	649	160	193
Transportation	8,109	8,433	9,632
Community and Regional Development	2,759	2,201	2,722
Education, Training, Employment and Social Services	164	168	163
Health	4,276	4,347	4,626
Medicare	8	12	14
Income Security	9	11	17
Social Security	151	173	179
Veterans Benefits and Services	250	310	314
Administration of Justice	14,241	14,784	16,210
General Government	778	819	862
Total, Homeland Security Budget Authority	**54,386**	**54,862**	**58,282**
Less National Defense, DoD	–17,186	–16,441	–16,699
Total, Homeland Security Budget Authority excluding BioShield	**37,200**	**38,421**	**41,583**
Less Fee-Funded Homeland Security Programs	–3,444	–4,127	–6,019
Less Mandatory Homeland Security Programs	–2,194	–2,232	–2,455
Net Discretionary, Homeland Security Budget Authority excluding BioShield	**31,562**	**32,062**	**33,109**
Plus BioShield	2,508	....	....
Net Discretionary, Homeland Security Budget Authority including BioShield	**34,070**	**32,062**	**33,109**

* FY 2005 Enacted estimates include supplemental appropriations.
** FY 2006 Enacted estimates exclude supplemental appropriations.

Table 3–13. BASELINE ESTIMATES—HOMELAND SECURITY FUNDING BY BUDGET FUNCTION

(Budget authority, in millions of dollars)

Budget Authority	2006 Enacted*	Baseline				
		2007	2008	2009	2010	2011
National Defense	20,771	21,303	21,904	22,509	23,132	23,777
International Affairs	1,107	1,131	1,157	1,180	1,205	1,230
General Science Space and Technology	616	629	643	658	670	685
Energy	124	129	119	124	126	131
Natural Resources and the Environment	285	292	301	310	319	327
Agriculture	541	555	568	584	597	612
Commerce and Housing Credit	160	182	1,154	174	179	185
Transportation	8,433	8,825	9,232	9,501	9,781	10,077
Community and Regional Development	2,201	2,252	2,302	2,352	2,403	2,454
Education, Training, Employment and Social Services	168	172	178	186	191	196
Health*	4,347	4,450	4,558	4,662	4,767	4,877
Medicare	12	12	13	14	14	15
Income Security	11	16	11	11	12	13
Social Security	173	177	181	185	189	191
Veterans Benefits and Services	310	318	326	334	340	349
Administration of Justice	14,784	15,438	15,898	16,463	17,029	17,620
General Government	819	832	852	866	885	900
Total, Homeland Security Budget Authority	**54,862**	**56,713**	**59,397**	**60,113**	**61,839**	**63,639**
Less National Defense, DoD	–16,441	–16,857	–17,343	–17,836	–18,341	–18,868
Net Discretionary, Homeland Security Budget Authority, excluding BioShield	**38,421**	**39,856**	**42,054**	**42,277**	**43,498**	**44,771**
Less Fee-Funded Homeland Security Programs	–4,127	–4,255	–4,350	–4,441	–4,537	–4,630
Less Mandatory Homeland Security Programs	–2,232	–2,455	–3,543	–2,650	–2,733	–2,820
Net Discretionary, Homeland Security Budget Authority	**32,062**	**33,146**	**34,161**	**35,186**	**36,228**	**37,321**
Plus BioShield	....	....	....	2,175	....	....
Net Discretionary, Homeland Security Budget Authority, including BioShield	**32,062**	**33,146**	**34,161**	**37,361**	**36,228**	**37,321**

* FY 2006 Enacted estimates exclude supplemental appropriations.

Detailed Estimates by Budget Account:

An appendix of account-level funding estimates, organized by *National Strategy* mission area, is available on the *Analytical Perspectives* CD ROM.

4. STRENGTHENING FEDERAL STATISTICS

Federal statistical programs produce key information to inform public and private decision makers about a range of topics of interest, including the economy, the population, agriculture, crime, education, energy, the environment, health, science, and transportation. The ability of governments, businesses, and citizens to make appropriate decisions about budgets, employment, investments, taxes, and a host of other important matters depends critically on the ready availability of relevant, accurate, and timely Federal statistics.

The Federal statistical community remains on alert for opportunities to strengthen these measures of our Nation's performance. For example, during 2005, Federal statistical agencies accelerated the release of Gross State Product by one year and released for the first time local area employee compensation by industry (BEA); published for the first time a price index for U.S. imports of goods from China (BLS); implemented the American Community Survey at its full level of three million addresses nationwide to provide detailed population data every month instead of once every 10 years (Census Bureau); presented primary information about the economic well-being of America's farmers and farm households from the Agricultural Resource Management Survey via an easy-to-use web-based delivery tool (ERS and NASS); and undertook the first data-sharing project under the Confidential Information Protection and Statistical Efficiency Act to improve understanding of international research and development investment activities of multinational corporations (BEA, Census Bureau, and NSF's SRS). During 2006, the Bureau of Justice Statistics will sponsor a new survey of businesses to estimate their exposure to and the consequences of computer crime, while the National Center for Health Statistics will field the National Survey of Ambulatory Surgery for the first time since 1996 to provide more comprehensive data on surgical procedures—many of which have moved from inpatient to outpatient settings.

For Federal statistical programs to effectively benefit their wide range of users, the underlying data systems must be viewed as credible. In order to foster this credibility, Federal statistical programs seek to adhere to high quality standards and to maintain integrity and efficiency in the production of data. As the collectors and providers of these basic statistics, the responsible agencies act as data stewards—balancing public and private decision makers' needs for information with legal and ethical obligations to minimize reporting burden, respect respondents' privacy, and protect the confidentiality of the data provided to the Government. This chapter discusses the development of standards that principal statistical programs use to assess their performance and presents highlights of their 2007 budget proposals.

Performance Standards

Statistical programs maintain the quality of their data or information products as well as their credibility by setting high performance standards for their activities. The statistical agencies and statistical units represented on the Interagency Council on Statistical Policy (ICSP) have collaborated on developing an initial set of common performance standards for use under the Government Performance and Results Act and in completing the Administration's Program Assessment Rating Tool (PART). Federal statistical agencies have agreed that there are six conceptual dimensions within two general areas of focus that are key to measuring and monitoring statistical programs. The first area of focus is Product Quality, encompassing the traditional dimensions of relevance, accuracy, and timeliness. The second area of focus is Program Performance, encompassing the dimensions of cost, dissemination, and mission achievement.

Statistical agencies historically have focused on measuring performance in the area of product quality, especially dimensions of accuracy and timeliness that are most amenable to quantitative measurement. Relevance, also an accepted measure of quality, can be either a qualitative description of the usefulness of products or a quantitative measure such as a customer satisfaction score. Relevance is more difficult to measure, and the indicators that do exist are more varied.

Program performance standards form the basis for evaluating effectiveness. They address questions such as: Are taxpayer dollars spent most effectively? Are products made available to those who need them? Are agencies meeting their mission requirements or making it possible for other agencies to meet their missions? The indicators available to measure program performance for statistical activities currently are less well developed.

Product quality and program performance standards are designed to serve as indicators when answering specific questions in the Administration's PART process. Chart 4–1 presents each principal Federal statistical agency's assessment of the status of its current and planned use of indicators on the six dimensions. During the past year, four agencies (BTS, EIA, NASS, and SRS) have completed development of their last few indicators. With the exception of cost indicators, where three agencies (ERS, NCES, and NCHS) are still planning their measures, the ICSP agencies have now developed performance measures for all six dimensions. Use of the indicators may be for internal management, strategic planning, or annual performance reporting. The dimensions shown in the chart reflect an overall set of indicators for statistical activities, but the specific measures vary among the individual programs depending on their unique characteristics and requirements. Annual performance reports and PARTs provide these specific measures, as well as additional information about performance goals and targets and whether a program is meeting, or making measurable progress toward meeting, its performance goals. The examples below illustrate different ways agencies track their performance on each dimension.

Chart 4-1. ICSP Statistical Quality and Program Performance Dimensions, 2007

Dimension	BEA	BJS	BLS	BTS	Census	EIA	ERS	NASS	NCES	NCHS	ORES	SOI	SRS
Product Quality													
Relevance	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Accuracy	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Timeliness	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Program Performance													
Cost	✓	✓	✓	✓	✓	✓	P	✓	P	P	✓	✓	✓
Dissemination	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Mission Achievement	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓

✓ Indicator Available P Indicator Planned

Description of Dimensions

Product Quality

Relevance: Qualitative or quantitative descriptions of the degree to which products and services are useful to users and responsive to users' needs.

Accuracy: Qualitative or quantitative measure of important features of correctness, validity, and reliability of data and information products measured as degree of closeness to target values.

Timeliness: Qualitative or quantitative measure of the timing of information releases.

Program Performance

Cost: Quantitative measure of the dollar amount used to produce data products and services.

Dissemination: Qualitative or quantitative information on the availability, accessibility, and distribution of products and services.

Mission Achievement: Qualitative or quantitative information about the effect of, or satisfaction with, statistical programs.

Key to Statistical Agencies

BEA = Bureau of Economic Analysis, Department of Commerce
BJS = Bureau of Justice Statistics, Department of Justice
BLS = Bureau of Labor Statistics, Department of Labor
BTS = Bureau of Transportation Statistics, Department of Transportation
Census = Census Bureau, Department of Commerce
EIA = Energy Information Administration, Department of Energy
ERS = Economic Research Service, Department of Agriculture
NASS = National Agricultural Statistics Service, Department of Agriculture
NCES = National Center for Education Statistics, Department of Education
NCHS = National Center for Health Statistics, Department of Health and Human Services
ORES = Office of Research, Evaluation, and Statistics, Social Security Administration
SOI = Statistics of Income, Internal Revenue Service, Department of the Treasury
SRS = Division of Science Resources Statistics, National Science Foundation

Product Quality: Statistical agencies agree that product quality encompasses many attributes, including (but not limited to) *relevance*, *accuracy,* and *timeliness*. The basic measures in this group relate to the quality of specific products, thereby providing actionable information to managers. These are "outcome-oriented" measures and are key to the usability of information products. Statistical agencies or units establish targets and monitor how well targets are met. In some sense, relevance relates to "doing the right things," while accuracy and timeliness relate to "doing things right."

Relevance: Qualitative or quantitative descriptions of the degree to which products and services are useful and responsive to users' needs. Relevance of data products and analytic reports may be monitored through a professional review process and ongoing contacts with data users. Product relevance may be indicated by customer satisfaction with product content, information from customers about product use, demonstration of product improvements, comparability with other data series, agency responses to customer suggestions for improvement, new or customized products or services, frequency of use, or responses to data requests from users (including policy makers). Through a variety of professional review activities, agencies maintain the relevance and validity of their products, and encourage data users and other stakeholders to contribute to the agencies' data collection and dissemination programs. Striving for relevance requires monitoring to ensure that information systems anticipate change and evolve to appropriately measure our dynamic society and economy.

Accuracy: Qualitative or quantitative measures of important features of correctness, validity, and reliability of data and information products measured as degree of closeness to target values. For statistical data, accuracy may be defined as the degree of closeness to the target value and measured as sampling error and various aspects of nonsampling error (e.g., response rates, size of revisions, coverage, edit performance). For analysis products, accuracy may be the quality of the reasoning, reasonableness of assumptions, and clarity of the exposition, typically measured and monitored through review processes. In addition, accuracy is assessed and improved by internal reviews, comparisons of data among different surveys, linkages of survey data to administrative records, redesigns of surveys, or expansions of sample sizes.

Timeliness: Qualitative or quantitative measure of timing of information releases. Timeliness may be measured as time from the close of the reference period to the release of information, or customer satisfaction with timeliness. Timeliness may also be measured as how well agencies meet scheduled and publicized release dates, expressed as a percent of release dates met.

Program Performance: Statistical agencies agree that program performance encompasses balancing the dimensions of cost, dissemination, and mission accomplishment for the agency as a whole; operating efficiently and effectively; ensuring that customers receive the information they need; and serving the information needs of the Nation. Costs of products or programs may be used to develop efficiency measures. Dissemination involves making sure customers receive the information they need via the most appropriate mechanisms. Mission achievement means that the information program makes a difference. Hence, three key dimensions are being used to indicate program performance: *cost* (input), *dissemination* (output), and *mission achievement* (outcome).

Cost: Quantitative measure of the dollar amount to produce data products or services. The development and use of financial performance measures within the Federal Government is an established goal; the intent of such measures is to determine the "true costs" of various programs or alternative modes of operation at the Federal level. Examples of cost data include full costs of products or programs, return on investment, dollar value of efficiencies, and ratios of cost to products distributed.

Dissemination: Qualitative or quantitative information on the availability, accessibility, and distribution of products and services. Most agencies have goals to improve product accessibility, particularly through the Internet. Typical measures include: on-demand requests fulfilled, product downloads, degree of accessibility, customer satisfaction with ease of use, number of participants at user conferences, citations of agency data in the media, number of Internet user sessions, number of formats in which data are available, amount of technical support provided to data users, exhibits to inform the public about information products, issuance of newsletters describing products, usability testing of web sites, and assessing compliance with Section 508 of the Rehabilitation Act, which requires Federal agencies to make their electronic and information technology accessible to people with disabilities.

Mission Achievement: Qualitative or quantitative information about the effect of, or satisfaction with, statistical programs. For Government statistical programs, this dimension responds to the question—have we achieved our objectives and met the expectations of our stakeholders? Under this dimension, statistical programs document their contributions to the goals and missions of parent departments and other agencies, the Administration, the Congress, and information users in the private sector and the general public. For statistical programs, this broad dimension involves meeting recognized societal information needs; it also addresses the linkage between statistical outputs and programmatic outcomes.

However, identifying this linkage is far from straightforward. It is frequently difficult to trace the effects of information products on the public good. Such products often are necessary intermediate inputs in the creation of high visibility information whose societal benefit is clearly recognized. For example, the economic statistics produced by a variety of agencies are directly used by the Bureau of Economic Analysis in the calculation of the Gross Domestic Product (GDP), which analysts universally use to assess changes in the level of domestic economic activity. Similarly, statistics from specific surveys are directly used by the Bureau of Labor Statistics in the calculation of the Consumer Price Index (CPI), which is widely used in diverse applications, such as indexing pensions for retirees. As a result, a number of statistical agencies can claim credit for contributing to the GDP and/or the CPI and to the many uses of these information products. In addition, statistics produced by Federal agencies are used to track the performance of programs managed by their parent or other organizations related to topics such as crime, education, energy, the environment, health, science, and transportation.

Moreover, beyond the direct and focused uses of statistical products, the statistical agencies and their programs serve a diverse and dispersed set of data users working on a broad range of applications. Users include government policy makers at the Federal, State, and local levels, business leaders, households, academic researchers, analysts at public policy institutes and trade groups, marketers and planners in the private sector, and many others. Information produced by statistical agencies often is combined with other information for use in the decision-making process. Thus, the relationship between program outputs and their beneficial uses and outcomes is often complex and difficult to track. Consequently, agencies use both qualitative and quantitative indicators to make this linkage as explicit as feasible.

In the absence of preferred quantitative indicators, qualitative narratives can indicate how statistical agency products contribute to and evaluate progress toward important goals established for government or private programs. In particular, narratives can highlight how statistical agencies measure the Nation's social and economic structure, and how the availability of the information influences changes in policies and programs. These narratives contribute to demonstrating mission accomplishment, particularly in response to questions in Section I of the PART, "program purpose and design." Narratives may describe statistical information's effects on measuring agency policy or change of policy, supporting research focused on policy issues, informing debate on policy issues, or providing in-house consulting support.

In addition to narratives, quantitative measures may be used to reflect mission achievement. For example, customer satisfaction with the statistical agency or unit indicates if the agency or unit has met the expectations of its stakeholders.

Of the 14 principal Federal statistical agencies that are members of the ICSP, nine agencies have programs that have been assessed using the PART process. Most of these agencies' programs have received PART summary ratings of Effective or Moderately Effective, as shown in Chart 4–2. While recognizing the strength of the Energy Information Administration's purpose and management, EIA received a rating of "Results Not Demonstrated" for two key reasons. As part of its 2004 strategic planning, EIA had begun to reassess its performance measures. As a result, EIA had not yet adopted new measures, nor established baselines and targets for the new measures. Also, EIA had no recurring independent evaluation of its entire program. EIA is working to establish these measures, targets, and baselines. In addition, in FY 2005 EIA initiated an independent Expert Study Team to review and assess EIA's entire information program. This team is scheduled to provide its report to EIA in spring 2006. As additional ICSP agencies have an opportunity to undergo the PART process, the agencies plan to continue to use the results of the collaborative performance standards development effort to help maintain and extend their generally favorable assessments.

Chart 4–2. Most Recent PART Summary Ratings for Statistical Programs

	Summary Rating
Bureau of Economic Analysis	Effective
Bureau of Justice Statistics	Effective
Bureau of Labor Statistics	Effective
Census Bureau	
Current Demographic Statistics	Effective
Decennial Census	Moderately Effective
Intercensal Demographic Estimates	Moderately Effective
Survey Sample Redesign	Effective
Economic Census	Effective
Current Economic Statistics/Census of Governments	Moderately Effective
Economic Research Service	Effective
Energy Information Administration	Results Not Demonstrated
National Agricultural Statistics Service	Moderately Effective
National Center for Education Statistics	
Statistics	Effective
Assessment	Effective
National Center for Health Statistics	Moderately Effective

Highlights of 2007 Program Budget Proposals

The programs that provide essential statistical information for use by governments, businesses, researchers, and the public are carried out by some 70 agencies spread across every department and several independent agencies. Approximately 40 percent of the funding for these programs provides resources for 13 agencies or units that have statistical activities as their principal mission. (Please see Table 4–1.) The remaining funding supports work in 60-plus agencies or units that carry out statistical activities in conjunction with other missions such as providing services or enforcing regulations. More comprehensive budget and program information about the Federal statistical system will be available in OMB's annual report, *Statistical Programs of the United States Government, Fiscal Year 2007*, when it is published later this year. The following highlights elaborate on the Administration's proposals to strengthen the programs of the principal Federal statistical agencies.

Bureau of Economic Analysis: Funding is requested to: (1) complete BEA's five-year program to improve the accuracy and timeliness of the National Income and Product Accounts, including acquiring and incorporating real-time data into the accounts to provide more current and reliable estimates and accelerating the release of gross state product and metropolitan personal income; (2) augment the scope of the international economic accounts by improving the comprehensiveness of international service statistics; (3) continue to update the input-output accounts and industry estimates; and (4) improve and enhance regional economic statistics.

Bureau of Justice Statistics: Funding is requested to provide for BJS's core statistical programs, including: (1) sample restoration for the National Crime Victimization Survey to support estimates of annual rates of change in most types of violent crime; (2) cybercrime statistics on the incidence, magnitude, and consequences of electronic and computer crime to households and businesses; (3) law enforcement data from over 3,000 agencies on the organization and administration of police and sheriffs' departments; (4) nationally representative prosecution data on resources, policies, and practices of local prosecutors; (5) court and sentencing statistics, including Federal and State case processing data; and (6) data on correctional populations and facilities from Federal, State, and local governments.

Bureau of Labor Statistics: Funding is requested to support program operations to measure the economy through producing, disseminating, and improving BLS economic measures, including activities to: (1) begin updating continuously the housing and geographic area samples in the Consumer Price Index (CPI), which will improve the accuracy and timeliness of the CPI; (2) continue to modernize the computing systems for monthly processing of the Producer Price Index (PPI) and U.S. Import and Export Price Indexes (IPP); and (3) expand the Business Employment Dynamics data within the Quarterly Census of Employment and Wages to cover State level measures of gross job gains and gross job losses.

Bureau of Transportation Statistics: Funding is requested to: (1) conduct the Commodity Flow Survey, a major national benchmark survey of shippers; (2) release monthly trade statistics on the commodities and mode of transportation used with our largest trading partners; (3) produce a core set of economic data and indicators including the Government Transportation Financial Report, multi-factor productivity measures, the State Transit Expenditure Survey, the Transportation Services Index, and the Air Travel Price Index; (4) produce and release the National Transportation Atlas Data Base, a compendium of national geospatial transportation data; (5) provide statistics in reference reports such as the Annual Report to Congress, the Pocket Guide to Transportation, the National Transportation Statistics Report, and the Transportation Services Index; and (6) carry out a national transportation information needs assessment, a new Congressional mandate to prioritize transportation data needs and data collections, and estimate their implementation costs.

Census Bureau: Funding is requested for the Census Bureau's ongoing economic and demographic programs and for a re-engineered 2010 Census. For the Census Bureau's economic and demographic programs, funding is requested to: (1) develop the collection instruments and processing systems for the 2007 Economic Census; (2) collect and process data in the organization phase of the Census of Governments, prepare and initiate data collection and processing in the employment phase, and collect and process data for the start of the finance phase; and (3) design a new data collection system on income and wealth dynamics that will meet the policy and operational needs of the country and replace the Survey of Income and Program Participation. For 2010 Census planning, funding is requested to continue to: (1) conduct planning, testing, and development activities to support a re-engineered 2010 Census; (2) improve the accuracy of map feature locations for an additional 690 counties; and (3) continue to conduct the American Community Survey program to provide small area demographic data on an ongoing basis rather than waiting for once-a-decade censuses.

Economic Research Service: Funding is requested to: (1) implement an Agricultural and Rural Development Information System, a comprehensive data collection and research program to ensure that sufficient data will consistently be available to monitor the changing economic health and structure of the farm and rural economies and to assess the economic well-being of farm and non-farm households in rural areas; and (2) extend ERS's integrated and comprehensive data and analysis framework, the Consumer Data and Information System, to include data on the consumption of food away from home, which will improve the ability of policy officials to understand, monitor, track, and identify changes in food supply and consumption patterns.

Energy Information Administration: Funding is requested to continue ongoing operations to: (1) maintain critical energy data coverage, analysis, and forecasting; (2) increase global oil and gas data and modeling capabilities through EIA's International Oil and Gas Markets and Energy Security Initiative, which will provide the basis for an enhanced global dialogue on the development and use of these key energy resources; (3) improve data reliability and statistical accuracy through EIA's Energy Data Quality Improvements Initiative, which will redesign key petroleum and natural gas surveys whose data drive investment and trade decisions, improve market function, and lead to efficient pricing; and (4) improve the ability to assess and forecast supply, demand, and technology trends affecting U.S. and world energy markets through the U.S. Energy Model Replacement Initiative.

National Agricultural Statistics Service: Funding is requested to: (1) continue restoration and modernization of the agricultural estimates program to ensure State, regional, and national level agricultural estimates of sufficient precision, quality, and detail to meet the needs of a broad customer base; and (2) finalize preparations for data collection associated with the 2007 Census of Agriculture, including collection of data to measure coverage of the mailing list and the preparation of all materials for data collection in 2008.

National Center for Education Statistics: Funding is requested to support: (1) on-going longitudinal studies, including the Early Childhood Longitudinal Study Birth and Kindergarten Cohorts and the Educational Longitudinal Study of 2002; (2) the Common Core of Data, which collects information on enrollment, completions, and finances from public elementary and secondary institutions; (3) the Integrated Postsecondary Education Data System, which collects information on enrollment, completions, and finances from postsecondary institutions; (4) the National Postsecondary Student Aid Survey, a comprehensive study that examines how students and their families pay for postsecondary education; (5) U.S. participation in international assessments that compare educational achievement in the United States with that in other countries; (6) the Schools and Staffing Survey, which provides information on public and private schools, the principals who head these schools, and the teachers who work in them; (7) a new longitudinal study that will follow an eighth grade cohort through the year following timely high school completion, and (8) expansion of the National Assessment of Educational Progress (NAEP), the only nationally representative and continuing assessment of what American students know and can do, to produce State estimates for grade 12.

National Center for Health Statistics: Funding is requested to: (1) continue data collection, analysis, and release for key national health data systems including the National Vital Statistics System, National Health Interview Survey, National Health and Nutrition Examination Survey, and National Health Care Survey; (2) continue gains in timeliness by implementing systems improvements in data collection and processing; (3) complete efforts to expand the content of surveys, particularly those addressing the health care delivery system; (4) implement the sample redesign for the National Health Interview Survey, NCHS' largest population survey; and (5) work collaboratively with States and other agencies on upgrading the technology for collecting data from State birth and death certificates.

Office of Research, Evaluation, and Statistics, SSA: Funding is requested to: (1) continue a strategic planning project to modernize ORES' processes for developing and disseminating data from the agency's major administrative data files for statistical purposes, (2) support outside surveys and linkage of Social Security Administration (SSA) administrative data to surveys, (3) create a new public-use file of administrative data on earnings histories and benefits for a sample of Social Security Numbers, and (4) evaluate the usefulness and confidentiality protection of a file being developed for public use that synthesizes data from the Survey of Income and Program Participation that is linked to SSA administrative records.

Science Resources Statistics Division, NSF: Funding is requested to: (1) improve the relevance, accuracy, timeliness, and accessibility of SRS statistical products, including the suite of research and development surveys; (2) extend the data, tools, and knowledge needed to develop, on an internationally comparable basis, a new set of science metrics in order to evaluate reliably the returns from past research and development investments and to forecast, within tolerable margins of error, likely returns from future investments; and (3) gather additional data on postdoctorate positions to address a major gap in Science and Engineering personnel data.

Statistics of Income Division, IRS: Funding is requested to: (1) maintain and modernize tax data collection systems, including developing interfaces with modern electronic tax return filing systems; (2) implement a databank repository for SOI and IRS population file data to more efficiently build longitudinal databases and enable sub-national estimates; (3) examine means to more effectively mask individual records to minimize the possibility of identification in the Individual Public Use Sample files; and (4) modernize and expedite dissemination of data and publications, including enhancement of products and features on the www.irs.gov/taxstats website.

Table 4–1. 2005–2007 BUDGET AUTHORITY FOR PRINCIPAL STATISTICAL AGENCIES

(in millions of dollars)

	2005 Actual	Estimate	
		2006 [1]	2007
Bureau of Economic Analysis [2]	73	76	76
Bureau of Justice Statistics [3]	47	46	60
Bureau of Labor Statistics	529	537	563
Bureau of Transportation Statistics	26	27	27
Census Bureau [4]	765	822	898
Salaries and Expenses [4]	216	216	204
Periodic Censuses and Programs	549	606	694
Economic Research Service [5]	74	75	83
Energy Information Administration	84	85	90
National Agricultural Statistics Service [6]	128	139	153
National Center for Education Statistics	185	183	190
Statistics	91	90	93
Assessment	89	88	92
National Assessment Governing Board	5	5	5
National Center for Health Statistics [7]	109	109	109
Office of Research, Evaluation, and Statistics, SSA	17	19	17
Science Resources Statistics Division, NSF	31	33	36
Statistics of Income Division, IRS	38	41	41

[1] Reflects any recissions.
[2] 2005 figure includes $2 million for a NAPA study of off-shoring.
[3] The 2005 and 2006 figures include funds for management and administrative costs that were previously displayed separately.
[4] Includes Mandatory Appropriations of $20 million for each year for the Survey of Program Dynamics and collection of data related to the allocation to States of State Chidren's Health Insurance Program funds.
[5] 2007 funding assumes the reallocation of $350,000 provided in 2006 for a comprehensive report on the economic development and current status of the sheep industry in the United States. Funding for that purpose will not be needed in 2007.
[6] Includes funds for the periodic Census of Agriculture of $22, $29, and $37 million in 2005, 2006, and 2007, respectively. The 2007 estimate includes an increase of $7.25 million due to cyclical activities for the Census of Agriculture.
[7] All funds from the Public Health Service Evaluation Fund. Administrative costs for NCHS that previously were displayed as part of the NCHS budget line are now reflected in two consolidated CDC-wide budget lines for management and administrative costs.

5. RESEARCH AND DEVELOPMENT

During the past five years the U.S. economy has shown remarkable resilience and vitality. Economic growth is now steady and strong. Incomes are rising, household net worth is at an all-time high, and unemployment is low and continues to decline. Meanwhile inflation remains in check, largely because of record sustained productivity growth—averaging a 3.4 percent annual rate for the past half-decade.

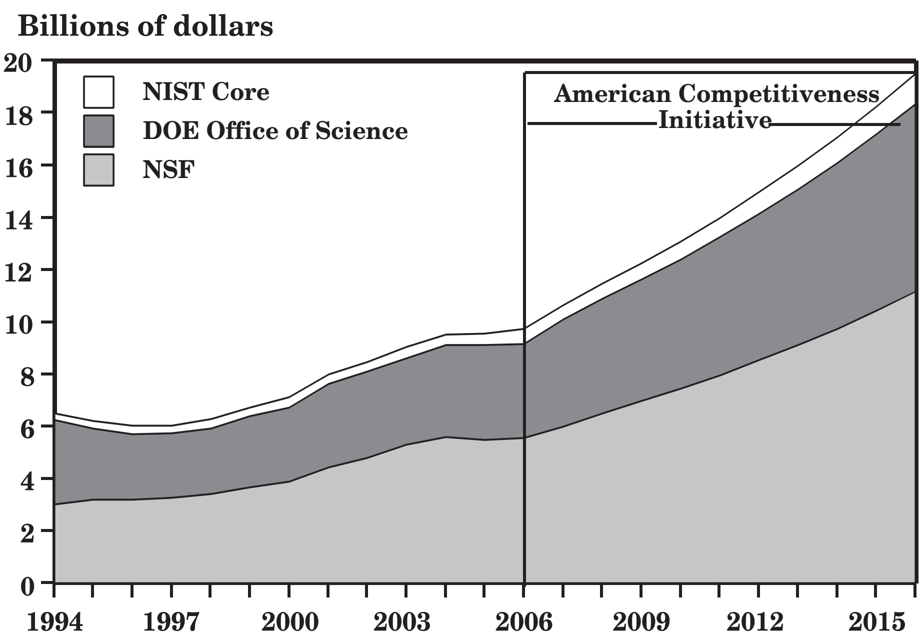
Our prosperity is no accident. The U.S. economy owes its strength in large measure to its willingness to build innovation capacity through the creation and growth of a world-class science and technology research enterprise and a high-quality scientific and technical education infrastructure. The relationship between support for science and economic growth is well documented. Investments in basic research lead to knowledge breakthroughs that fuel innovation, drive productivity, grow the economy, and change the way we see the world. Economists estimate that approximately half of post-World War II economic growth is directly due to technological progress fueled by research and development (R&D).

Economic payoffs to research come in the form of process and product innovations that reduce the costs of production, lower product prices, and result in new and better products and services. Consumers ultimately benefit from less expensive, higher quality and more useful products and services, and of course from earnings accruing to innovative companies. Today's transforming technologies and most popular consumer items have deep roots in basic and applied research.

By nearly every relevant metric, the U.S. leads the world in science and technology. With only about five percent of the world's population, the U.S. employs nearly one-third of all scientists and engineers and accounts for approximately one-third of global R&D spending (more than the rest of the G-8 nations combined), and U.S. researchers publish 35 percent of global science and engineering articles.

To sustain the nation's economic competitiveness, the President has called for a long-term vision to strengthen Federal support for the Nation's innovation enterprise in an integrated package of investments and policies in the American Competitiveness Initiative.

Chart 5-1. American Competitiveness Initiative Research



I. THE AMERICAN COMPETITIVENESS INITIATIVE

The centerpiece of the American Competitiveness Initiative in the President's 2007 Budget is a strong commitment to invest in basic research areas that advance knowledge and technologies used by scientists in nearly every field. Through the American Competitiveness Initiative, President Bush plans to double, over 10 years, investment in innovation-enabling research at three Federal agencies—the National Science Foundation (NSF), the Department of Energy's (DOE's) Office of Science, and the Department of Commerce's National Institute of Science and Technology (NIST) laboratories.

In 2007, the first year of the American Competitiveness Initiative, President Bush proposes $10.7 billion total for these agencies, an overall funding increase of $910 million, or 9.3 percent, above 2006. To reach doubling within ten years, overall annual increases will average roughly seven percent.

Research Agencies in the American Competitiveness Initiative

The National Science Foundation is the primary source of support for academic research in the physical sciences, funding potentially transformative basic research in areas such as nanotechnology, advanced networking and information technology, physics, chemistry, materials science, mathematics, and engineering. It is well regarded for management of funding through a competitive, peer-reviewed process. The increase in NSF funding is expected to support as many as 500 more research grants in 2007 and 6,400 additional researchers, students, post-doctoral fellows and technicians contributing to the innovation enterprise.

The Department of Energy's Office of Science supports grants and infrastructure for a wide range of basic research related to economically significant innovations including nanotechnology, biotechnology, high-end computing and advanced networking, and energy technologies. In addition to supporting 2,600 (10 percent) more researchers in 2007 than in 2006, the initiative provides for the construction of a number of cutting-edge scientific research tools with direct implications for economically-relevant R&D, including the world's most powerful civilian supercomputer and an x-ray light source user facility with world-leading capabilities to study materials, chemicals, and biological matter at the scale of an individual atom.

The Department of Commerce's National Institute of Standards and Technology is a high-leverage Federal research agency that supports economically significant innovations such as new materials and processes, electronics, computing and information technologies, advanced manufacturing integration, biotechnology, new energy sources such as hydrogen, and nanotechnology. NIST also plays a critical role in supporting standards development activities that are used by industry and government agencies.

II. IMPROVING THE PERFORMANCE OF R&D PROGRAMS

R&D is critically important for keeping our Nation economically competitive, and it will help solve the challenges we face in health, defense, energy, and the environment. Therefore, every Federal R&D dollar must be invested as effectively as possible.

R&D Investment Criteria

The Administration continues to improve the effectiveness of the Federal Government's investments in R&D by applying transparent investment criteria in analyses that inform recommendations for program funding and management. R&D performance assessment must be done with care. Research often leads scientists and engineers down unpredictable pathways with unpredictable results. This outcome can require special consideration when measuring an R&D program's performance against its initial goals.

With this in mind, the Administration is improving methods for setting priorities based on expected results, and is asking agencies to apply specific criteria that programs or projects must meet to be started or continued and supply clear milestones for gauging progress and improved metrics for assessing results.

As directed by the President's Management Agenda, the R&D Investment Criteria accommodate the wide range of R&D activities, from basic research to development and demonstration programs, by addressing three fundamental aspects of R&D:

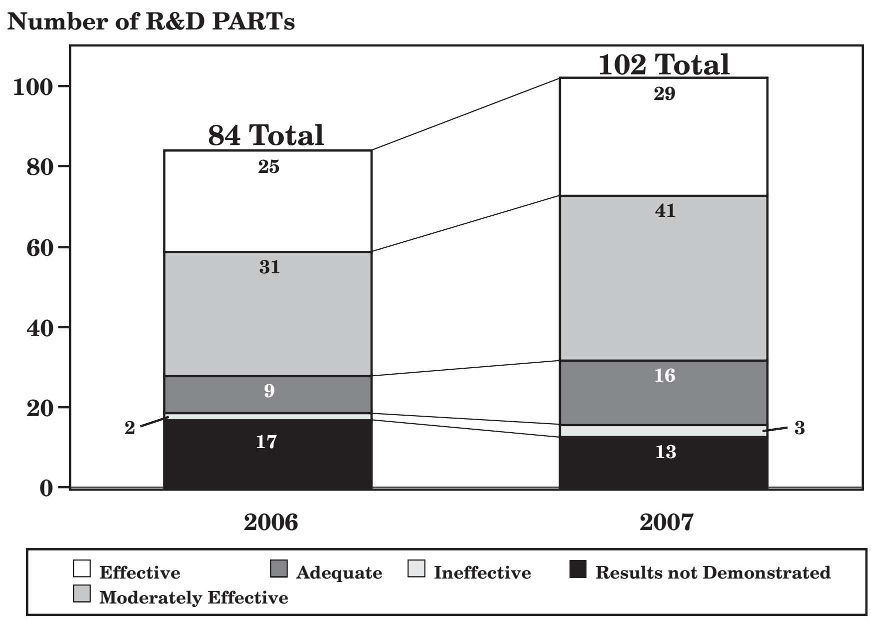
- *Relevance*—Programs must be able to articulate *why* they are important, relevant, and appropriate for Federal investment;
- *Quality*—Programs must justify *how* funds will be allocated to ensure quality; and
- *Performance*—Programs must be able to monitor and document *how well* the investments are performing.

In addition, R&D projects and programs relevant to industry are expected to apply criteria to determine the appropriateness of the public investment, enable comparisons of proposed and demonstrated benefits, and provide meaningful decision points for completing or transitioning the activity to the private sector.

As part of the President's Management Agenda's Budget and Performance Integration initiative, the Administration uses the Program Assessment Rating Tool (PART) to consistently assess the effectiveness of programs. A section of the PART specifically addresses the assessment of R&D program management and performance and is aligned with the R&D Investment criteria. In the last four years, agencies completed 795 PART assessments, of which 102 were for R&D programs. The results of these PART assessments may be found on the web at *www.whitehouse.gov/omb/part/*.

Performance assessments help policy makers identify those programs that are the most effective and worthy of funding; however, the Administration does not allocate funding levels and initiate management reforms strictly by formula or based solely on PART results. For instance, funding may be reduced for Effective programs that have achieved what they set out to do, and Ineffective programs might receive more money if it is clear it would help them become more effective. The PART provides information that leads to more informed decisions.

Chart 5-2. Scores of R&D PART Assessments



R&D agencies will continue to integrate the R&D Criteria more meaningfully into the budget formulation process in the coming year. Based on lessons learned and other feedback from experts and stakeholders, the Administration will continue to improve the R&D Investment Criteria and their implementation to achieve more effective management of R&D programs and better-informed budget-allocation decisions.

President's Management Agenda Initiative

Research and Development Investment Criteria

FY 2006, Quarter 1 Status: RED, Progress: YELLOW

The initiative's red status score reflects the limited success many agencies have had in the Government-wide implementation of the initiative. The yellow progress score indicates that the initiative maintains momentum, as more R&D agencies use the criteria to assess their programs. All of the top 13 R&D agencies are using the R&D PART to assess their programs this year.

Research Earmarks

The Administration strongly supports awarding research funds based on merit review through a competitive process refereed by scientists. Such a system has the best prospects for ensuring that the top research is supported. Research earmarks—in general the assignment of money during the legislative process for use by a specific organization or project—are counter to a merit-based competitive selection process. Earmarks signal to potential investigators that there is an acceptable alternative to creating quality research proposals for merit-based consideration. Such an alternative can be an ineffective use of taxpayer funds.

Unfortunately, the practice of earmarking funds to colleges, universities, and other entities for specific research projects has expanded dramatically in recent years. The American Association for the Advancement of Science (AAAS) recently estimated that R&D earmarks total $2.4 billion in 2006, an increase of 13 percent over the Association's 2005 estimate. The AAAS uses a relatively narrow definition of an R&D earmark. Other organizations have estimated even higher levels of R&D earmarking.

Some argue that earmarks help spread the research money to states or institutions that would receive less research funding through other means. *The Chronicle of Higher Education* has reported that this is not the main role earmarks play. Often only a minor portion of academic earmark funding goes to the states with the smallest shares of Federal research funds.

Some proponents of earmarking assert that earmarks provide a means of funding unique projects that would not be recognized by the conventional peer-review process. To address this concern, a number of research agencies have procedures and programs to reward "out-of-the-box" thinking. Within the Department of Defense (DOD), the Defense Advanced Research Projects Agency seeks out high-risk, high-payoff scientific proposals, and program managers at the NSF set aside a share of funding for higher-risk projects in which they see high potential.

Earmarks that are outside of an agency's mission can detract from an efficient and effective Federal effort on behalf of taxpayers. For instance, the Congress directed DOD to fund research on a wide range of diseases including ovarian cancer, prostate cancer, diabetes, leukemia, and childhood cancer. Congressional adds in DOD's budget for medical research projects totals about $900 million in 2006 alone. While research on these diseases is very important, it is generally not unique to the U.S. military and can be better selected, carried out and coordinated within civil medical research agencies, without disruption to the military mission. At the same time, intrusion of earmarks into the peer-review processes of civilian medical research agencies would have a significant detrimental impact on funding the most important and promising research.

Earmarks that divert funding from a merit-based process will undermine America's research productivity. The Administration commends Congress for taking measures to protect NSF and the National Institutes of Health from this practice, which is a practice that should be followed throughout the R&D programs.

III. PRIORITIES FOR FEDERAL RESEARCH AND DEVELOPMENT

The 2007 Budget requests $137 billion for Federal R&D funding, which targets key research investments within agencies such as NSF, the DOE's Office of Science, and the Department of Commerce's National Institute of Standards and Technology laboratories. (Table 5–1 provides details by agency).

The "Federal Science and Technology" (FS&T) budget (shown in Table 5–2) highlights the creation of new knowledge and technologies more consistently and accurately than overall R&D data collection. The FS&T budget emphasizes research; does not count funding for defense development, testing, and evaluation; and totals less than half of Federal R&D spending. The 2007 Budget requests $60 billion for FS&T.

Multi-Agency R&D Priorities

The 2007 Budget targets important research investments that must be coordinated across multiple agencies. Three of these multi-agency initiatives—nanotechnology, information technology R&D, and climate change science—are coordinated by three separate dedicated offices to ensure unified strategic planning and implementation. The Administration is strengthening interagency coordination for other priority areas—such as improving cybersecurity. The Administration will continue to analyze other areas of critical need that could benefit in the future from improved focus and coordination among agencies.

Combating Terrorism R&D: Significant advances in securing the homeland and winning the war on terror have been made over the past few years through the focused application of the Nation's science and technology capability. Challenges remain, however, a number of which are being addressed through multi-agency research efforts that are coordinated through the National Science and Technology Council (NSTC) and other inter-agency fora.

In 2005, multi-agency R&D funding efforts made significant progress towards increasing the security of the homeland. A key example is the formation of the Domestic Nuclear Detection Office (DNDO). DNDO has the primary responsibility for developing a comprehensive system to detect and mitigate any attempt to illicitly import, assemble or transport a nuclear explosive device or its components into the U.S. To accomplish this mission, DNDO coordinates and draws upon the R&D expertise of key departments and agencies. An interagency group led by the Office of Science and Technology Policy has continued to support these and other related efforts by generating a long-term nuclear security R&D vision and roadmap. In another example, interagency research programs such as the Face Recognition Grand Challenge are advancing core biometrics technologies and enhancing our understanding of the critical nexus between technical and privacy considerations.

The 2007 Budget provides continued support for these and many other homeland security related research areas, including R&D aimed at: finding and applying quick and cost-effective decontamination capabilities following a biological, chemical, nuclear or radiological incident; strengthening predictive modeling capabilities to augment our ability to assess the rate of geographic spread of infectious diseases or chemical agents or predict the impact of key policy decisions on factors affecting disease transmission; enhancing the safety of the Nation's food supply and agricultural systems through research directed at the epidemiology and ecology of emerging plant and animal diseases, and the development of more effective vaccine and diagnostic technologies; and enhancing cyber security through the Networking and Information Technology R&D program.

Networking and Information Technology R&D: The Budget provides $3 billion for the multi-agency Networking and Information Technology Research and Development (NITRD) Program, which plans and coordinates agency research efforts in high-end computing systems, large-scale networking, software development, high-confidence systems, information management, cyber security, and other information technologies. The agencies involved in this program coordinate efforts to accelerate research advancement in information technology, upon which every economic sector now depends.

In 2005, agencies participating in high-end computing R&D continued to make significant progress in implementing the recommendations contained in the Federal Plan for High-End Computing. The 2007 Budget provides for substantially increased activities in Leadership Class Computing by both DOE and NSF, one of the priorities contained in the Federal Plan. Relevant agencies will continue to conduct research in scalable systems software and applications to ensure that Federal investments in high-end computing achieve maximal impact.

Participating agencies will broaden their R&D activities in cyber security and information assurance, continuing to emphasize interagency coordination. For example, the Interagency Working Group (IWG) that coordinates R&D on information technology infrastructure protection was incorporated as part of the NITRD program in 2005, strengthening the connection between cyber security R&D and overall infrastructure protection. After completion of the Federal Plan for Cyber Security and Information Assurance R&D, the IWG will develop a roadmap for addressing any identified R&D gaps. Reports and general information about NITRD are available at *www.nitrd.gov/*.

Nanotechnology R&D: The Budget provides $1 billion for the multi-agency National Nanotechnology Initiative (NNI). The NNI focuses on R&D that creates materials, devices, and systems that exploit the fundamentally distinct properties of matter as it is manipulated at the atomic and molecular levels. The results of NNI-supported R&D are already leading to breakthroughs in disease detection and treatment, manufacturing at the nanoscale level, environmental monitoring and protection, energy production and storage, and creating electronic devices that have even greater capabilities than those available today.

Guided by the NNI, participating agencies will continue to focus on fundamental and applied research through investigator-led activities, multidisciplinary centers of excellence, education and training of nanotechnology workers, and infrastructure development, including user facilities and networks that are broadly available to researchers from across the scientific research community. In addition, agencies continue to maintain a focus on the responsible development of nanotechnology, with attention to the human and environmental health impacts, as well as ethical, legal, and other societal issues. Reports and general information about the NNI are available at *www.nano.gov/*.

Climate Change R&D: The 2007 Budget for the Climate Change Science Program (CCSP) continues to support the implementation of the CCSP Strategic Plan, which was released in July 2003. The 13 departments and agencies that participate in CCSP coordinate preparation of the budget and program implementation. During 2007, CCSP will continue research into important scientific uncertainties and preparation of a series of *Synthesis and Assessment* reports. The program expects to receive input from the National Research Council under the terms of a continuing advisory agreement. CCSP will continue to track deliverables and milestones for each of its programs in order to assess overall performance. Additional detail on individual agency activities will be provided in the Administration's 2007 edition of *Our Changing Planet.* Reports and general information about CCSP are available on the program's website: *www.climatescience.gov/*.

The Climate Change Technology Program (CCTP) continues to provide strategic direction and planning to help coordinate and prioritize activities within the portfolio of Federally funded climate change technology R&D consistent with the President's National Climate Change Technology Initiative (NCCTI). In 2005, the CCTP published a Vision and Framework for Strategy and Planning and released a draft Strategic Plan for review by the scientific community and the public. In 2006, the CCTP will address the nearly 300 comments received and publish a final Strategic Plan. The CCTP has also identified within its portfolio a subset of NCCTI priority activities, defined as discrete R&D activities that address technological challenges, which, if solved, could advance technologies with the potential to dramatically reduce, avoid, or sequester greenhouse gas emissions. Reports and general information about the CCTP are available on the program's website: *www.climatetechnology.gov/*.

The CCSP and CCTP will coordinate implementation of relevant climate change provisions in the 2005 Energy Policy Act as appropriate.

Hydrogen R&D: In 2005, the Hydrogen R&D Interagency Task Force led interagency coordination in hydrogen-related manufacturing and innovation, safety, codes and standards, and fundamental research on fuel cells, hydrogen production, and hydrogen storage. The Task Force established a web portal (*www.hydrogen.gov*) for hydrogen and fuel cell information. Additionally, the Task Force works with the International Partnership for the Hydrogen Economy, which coordinates hydrogen research among 15 nations representing two thirds of global energy consumption.

DOE will continue the President's Hydrogen Fuel Initiative to accelerate the worldwide availability and affordability of hydrogen-powered fuel cell vehicles. The initiative, which includes a 54-percent increase in targeted basic research investments in 2007, focuses on research to advance hydrogen production, storage, and infrastructure. The Initiative complements the Department's FreedomCAR Partnership with the auto industry, which is aimed at developing viable hydrogen fuel cell vehicle technology. To keep FreedomCAR on track, it will be essential that Congress refrain from earkmarking this program.

Stimulating Private Investment

Along with direct spending on R&D, the Federal Government has sought to stimulate private R&D investment through incentives in the Internal Revenue Code. A long-standing credit that expired at the end of 2005 provided a 20-percent tax credit for private research and experimentation expenditures above a certain base amount. The Administration proposes extending the Research and Experimentation tax credit starting 2006 and making it permanent. The proposed extension will cost $33.4 billion over the period from 2007 to 2011. In addition, a permanent tax provision lets companies deduct, up front, the costs of certain kinds of research and experimentation, rather than capitalize these costs. Also, equipment used for research benefits from relatively rapid tax depreciation allowance.

IV. FEDERAL R&D DATA

Federal R&D Funding

R&D is the collection of efforts directed towards gaining greater knowledge or understanding and applying knowledge toward the production of useful materials, devices, and methods. R&D investments can be characterized as basic research, applied research, development, R&D equipment, or R&D facilities, and the Office of Management and Budget has used those or similar categories in its collection of R&D data since 1949.

Basic research is defined as systematic study directed toward greater knowledge or understanding of the fundamental aspects of phenomena and of observable facts without specific applications towards processes or products in mind.

Applied research is systematic study to gain knowledge or understanding necessary to determine the means by which a recognized and specific need may be met.

Development is systematic application of knowledge toward the production of useful materials, devices, and systems or methods, including design, development, and improvement of prototypes and new processes to meet specific requirements.

Research and development equipment includes acquisition or design and production of movable equipment, such as spectrometers, microscopes, detectors, and other instruments.

Research and development facilities include the acquisition, design, and construction of, or major repairs or alterations to, all physical facilities for use in R&D activities. Facilities include land, buildings, and fixed capital equipment, regardless of whether the facilities are to be used by the Government or by a private organization, and regardless of where title to the property may rest. This category includes such fixed facilities as reactors, wind tunnels, and particle accelerators.

There are over twenty Federal agencies that fund R&D in the U.S. The nature of the R&D that these agencies fund depends on the mission of each agency and on the role of R&D in accomplishing it. Table 5–1 shows agency-by-agency spending on basic and applied research, development, and R&D equipment and facilities.

Table 5–1. FEDERAL RESEARCH AND DEVELOPMENT

(Budget authority, dollar amounts in millions)

	2005 Actual	2006 Estimate	2007 Proposed	Dollar Change: 2006 to 2007	Percent Change: 2006 to 2007
By Agency					
Defense	69,743	71,946	74,234	2,288	3%
Health and Human Services	28,687	28,767	28,737	–30	0%
NASA	10,197	11,394	12,245	851	7%
Energy	8,596	8,563	9,158	595	7%
National Science Foundation	4,138	4,199	4,548	349	8%
Agriculture	2,410	2,411	2,012	–399	–17%
Homeland Security	1,182	1,484	1,508	24	2%
Commerce	1,133	1,079	1,065	–14	–1%
Veteran Affairs	742	765	765		
Interior	622	637	600	–37	–6%
Transportation	549	704	557	–147	–21%
Environmental Protection Agency	640	600	557	–43	–7%
Other	1,235	1,232	1,218	–14	–1%
Total	**129,874**	**133,781**	**137,204**	**3,423**	**3%**
Basic Research					
Defense	1,485	1,470	1,422	–48	–3%
Health and Human Services	15,752	15,996	16,037	41	0%
NASA	2,386	2,305	2,226	–79	–3%
Energy	2,937	2,987	3,315	328	11%
National Science Foundation	3,427	3,478	3,687	209	6%
Agriculture	838	846	771	–75	–9%
Homeland Security	55	95	49	–46	–48%
Commerce	53	56	87	31	55%
Veteran Affairs	297	306	306		
Interior	36	42	40	–2	–5%
Transportation	33	39	39		
Environmental Protection Agency	110	101	94	–7	–7%
Other	155	169	174	5	3%
Subtotal	**27,564**	**27,890**	**28,247**	**357**	**1%**
Applied Research					
Defense	4,787	5,169	4,478	–691	–13%
Health and Human Services	12,573	12,605	12,540	–65	–1%
NASA	1,957	1,759	1,118	–641	–36%
Energy	2,770	2,730	2,723	–7	0%
National Science Foundation	332	319	379	60	19%
Agriculture	1,124	1,157	974	–183	–16%
Homeland Security	842	1,093	943	–150	–14%
Commerce	813	779	769	–10	–1%
Veteran Affairs	401	414	414		
Interior	533	545	510	–35	–6%
Transportation	304	392	305	–87	–22%
Environmental Protection Agency	415	387	359	–28	–7%
Other	587	591	594	3	1%
Subtotal	**27,438**	**27,940**	**26,106**	**–1,834**	**–7%**
Development					
Defense	63,336	65,221	68,315	3,094	5%
Health and Human Services	57	37	37		
NASA	3,494	5,174	6,755	1,581	31%
Energy	1,759	1,804	1,990	186	10%
National Science Foundation					N/A
Agriculture	156	164	155	–9	–5%
Homeland Security	133	195	335	140	72%
Commerce	148	118	94	–24	–20%
Veteran Affairs	44	45	45		
Interior	50	47	47		
Transportation	194	255	194	–61	–24%
Environmental Protection Agency	115	112	104	–8	–7%
Other	461	424	409	–15	–4%
Subtotal	**69,947**	**73,596**	**78,480**	**4,884**	**7%**
Facilities and Equipment					
Defense	135	86	19	–67	–78%
Health and Human Services	305	129	123	–6	–5%

Table 5–1. FEDERAL RESEARCH AND DEVELOPMENT—Continued

(Budget authority, dollar amounts in millions)

	2005 Actual	2006 Estimate	2007 Proposed	Dollar Change: 2006 to 2007	Percent Change: 2006 to 2007
NASA	2,360	2,156	2,146	–10	0%
Energy	1,130	1,042	1,130	88	8%
National Science Foundation	379	402	482	80	20%
Agriculture	292	244	112	–132	–54%
Homeland Security	152	101	181	80	79%
Commerce	119	126	115	–11	–9%
Transportation	....	....	....	....	N/A
Veterans Affairs	3	3	3	....	N/A
Interior	18	18	19	1	6%
Environmental Protection Agency	....	....	....	....	N/A
Other	32	48	41	–7	–15%
Subtotal	**4,925**	**4,355**	**4,371**	**16**	**0%**

Table 5–2. FEDERAL SCIENCE AND TECHNOLOGY BUDGET

(Budget authority, dollar amounts in millions)

	2005 Actual	2006 Estimate	2007 Proposed	Dollar Change: 2006 to 2007	Percent Change: 2006 to 2007
By Agency					
National Institutes of Health [1]	**28,444**	**28,410**	**28,428**	**18**	**0%**
NASA	**8,128**	**7,680**	**7,073**	**–607**	**–8%**
Science	5,502	5,254	5,330	76	1%
Aeronautics	962	884	724	–160	–18%
Exploration Systems [2]	1,664	1,542	1,019	–523	–34%
Energy [3]	**5,642**	**5,636**	**6,155**	**519**	**9%**
Science Programs	3,600	3,596	4,102	506	14%
Electricity Transmission & Distribution	101	136	96	–40	–29%
Nuclear Energy	393	416	559	143	34%
Energy Efficiency and Renewable Energy Resources [4]	976	896	933	37	4%
Fossil Energy [5]	572	592	465	–127	–21%
National Science Foundation	**5,472**	**5,581**	**6,020**	**439**	**8%**
Defense	**6,273**	**6,628**	**5,900**	**–728**	**–11%**
Basic Research	1,485	1,470	1,422	–48	–3%
Applied Research	4,788	5,158	4,478	–680	–13%
Agriculture	**2,111**	**2,160**	**1,921**	**–239**	**–11%**
CSREES Research and Education [6]	659	675	569	–106	–16%
Economic Research Service	74	75	83	8	11%
Agricultural Research Service [7]	1,102	1,131	1,001	–130	–11%
Forest Service: Forest and Rangeland Research	276	279	268	–11	–4%
Interior (USGS)	**935**	**962**	**945**	**–17**	**–2%**
Commerce	**855**	**938**	**873**	**–65**	**–7%**
NOAA: Oceanic & Atmospheric Research	404	370	338	–32	–9%
NIST Intramural Research and Facilities	451	568	535	–33	–6%
Environmental Protection Agency [8]	**780**	**761**	**816**	**55**	**7%**
Veterans Affairs [9]	**743**	**765**	**765**	....	....
Transportation	**542**	**567**	**598**	**31**	**5%**
Highway research: Federal Highway Administration	411	430	468	38	9%
Federal Aviation Administration: Research, Engineering, and Development	131	137	130	–7	–5%
Education	**355**	**342**	**342**	....	....
Special Education Research and Innovation	83	72	72	....	....
National Institute on Disability and Rehabilitation Research	108	107	107	....	....
Research, Development, and Dissemination [10]	164	163	163	....	....
Total	**60,280**	**60,430**	**59,836**	**–594**	**–1%**

[1] In 2006, the Department of Health and Human Services will allocate an additional $18 million to NIH for Pandemic Influenza research from the Department of Defense Emergency Supplemental Appropriations to Address Hurricanes in the Gulf of Mexico, and Pandemic Influenza Act, 2006.
[2] Includes Exploration Systems Research and Technology, Human Systems Research and Technology, Innovative Partnerships, and Prometheus Nuclear Systems and Technology.
[3] Data do not reflect actual transfers to Science Programs from other Department of Energy R&D programs to support the Small Business Innovation Research and the Small Business Technology Transfer programs.
[4] In 2006, Congress merged the Energy Supply and Energy Conservation accounts. The amount reported under the new Energy Efficiency and Renewable Energy Resources line within this account reflects a combination of the former Energy Conservation line item (excluding Weatherization and State grants) and the Renewables line item.
[5] Excludes funding for the Alaska Natural Gas Pipeline project.
[6] Includes the appropriation of earnings from the Native American Endowment Fund, but not the appropriation to the Endowment's principal.
[7] Excludes building and facilities. Also excludes the transfer of $6 million from the account.
[8] Science and Technology, plus superfund transfer.
[9] Includes the medical care and prosthetic research appropriation and VA medical care support transfer to research.
[10] Does not include funding for Regional Educational Labs.

Table 5–3. AGENCY DETAIL OF SELECTED INTERAGENCY R&D EFFORTS

(Budget authority, dollar amounts in millions)

	2005 Actual	2006 Estimate	2007 Proposed	Dollar Change: 2006 to 2007	Percent Change: 2006 to 2007
Networking and Information Technology R&D					
Defense [1]	775	1,128	1,018	–110	–10%
National Science Foundation	811	810	904	94	12%
Health and Human Services [2]	571	551	541	–10	–2%
Energy	377	384	473	89	23%
National Aeronautics and Space Administration	163	78	82	4	5%
Commerce	60	60	65	5	8%
Environmental Protection Agency	4	6	6	......	......
Total	**2,761**	**3,017**	**3,089**	**72**	**2%**
National Nanotechnology Initiative					
National Science Foundation	335	344	373	29	8%
Defense [1]	352	435	345	–90	–21%
Energy	208	207	258	51	25%
Health and Human Services [3]	168	175	173	–2	–1%
Commerce (NIST)	79	76	86	10	13%
National Aeronautics and Space Administration	45	50	25	–25	–50%
Environmental Protection Agency	7	5	9	4	80%
Agriculture	3	5	5	......	......
Justice	2	1	1	0	0%
Homeland Security	1	1	......	–1	–100%
Total	**1,200**	**1,299**	**1,275**	**–24**	**–2%**
Climate Change Science Program					
National Aeronautics and Space Administration	1,237	1,043	1,025	–18	–2%
National Science Foundation	198	197	205	8	4%
Commerce (NOAA)	124	163	186	23	14%
Energy	127	131	126	–5	–4%
Agriculture	62	62	61	–1	–2%
National Institutes of Health	57	57	57	......	......
Interior (USGS)	27	27	26	–1	–4%
Environmental Protection Agency	20	19	17	–2	–11%
Smithsonian	6	6	6	......	......
U.S. Agency for International Development	6	6	6	......	......
Transportation	3	2	2	......	......
State	1	......	......	......	......
Total	**1,868**	**1,713**	**1,717**	**4**	**0%**
Subtotal, CCRI (included in CCSP total)	**211**	**200**	**200**	**0**	**0%**

[1] In 2005, DOD reviewed its contributions to NITRD and NNI and produced a more comprehensive and accurate accounting of the Department's funding of those activities. Accordingly, the funding levels shown in this table are larger than those shown in previous years.
[2] Includes funds from offsetting collections for the Agency for Healthcare Research and Quality.
[3] Includes funds from both the National Institutes of Health and National Institute of Occupational Safety and Health.

6. FEDERAL INVESTMENT

Investment spending is spending that yields long-term benefits. Its purpose may be to improve the efficiency of internal Federal agency operations or to increase the Nation's overall stock of capital for economic growth. The spending can be direct Federal spending or grants to State and local governments. It can be for physical capital, which yields a stream of services over a period of years, or for research and development or education and training, which are intangible but also increase income in the future or provide other long-term benefits.

Most presentations in the Federal budget combine investment spending with spending for current use. This chapter focuses solely on Federal and federally financed investment.

In this chapter, investment is discussed in the following sections:

- a description of the size and composition of Federal investment spending;
- a discussion of the performance of selected Federal investment programs; and
- a presentation of trends in the stock of federally financed physical capital, research and development, and education.

PART I: DESCRIPTION OF FEDERAL INVESTMENT

For more than fifty years, the Federal budget has included a chapter on Federal investment—defined as those outlays that yield long-term benefits—separately from outlays for current use. In recent years the discussion of the composition of investment has displayed estimates of budget authority as well as outlays.

The classification of spending between investment and current outlays is a matter of judgment. The budget has historically employed a relatively broad classification, encompassing physical investment, research, development, education, and training. The budget further classifies investments into those that are grants to State and local governments, such as grants for highways or education, and all other investments, called "direct Federal programs" in this analysis. This "direct Federal" category consists primarily of spending for assets owned by the Federal Government, such as defense weapons systems and general purpose office buildings, but also includes grants to private organizations and individuals for investment, such as capital grants to Amtrak or higher education loans directly to individuals.

Presentations for particular purposes could adopt different definitions of investment:

- To suit the purposes of a traditional balance sheet, investment might include only those physical assets owned by the Federal Government, excluding capital financed through grants and intangible assets such as research and education.
- Focusing on the role of investment in improving national productivity and enhancing economic growth would exclude items such as national defense assets, the direct benefits of which enhance national security rather than economic growth.
- Concern with the efficiency of Federal operations would confine the coverage to investments that reduce costs or improve the effectiveness of internal Federal agency operations, such as computer systems.
- A "social investment" perspective might broaden the coverage of investment beyond what is included in this chapter to include programs such as childhood immunization, maternal health, certain nutrition programs, and substance abuse treatment, which are designed in part to prevent more costly health problems in future years.

The relatively broad definition of investment used in this section provides consistency over time—historical figures on investment outlays back to 1940 can be found in the separate *Historical Tables* volume. Table 6–2 at the end of this section allows disaggregation of the data to focus on those investment outlays that best suit a particular purpose.

In addition to this basic issue of definition, there are two technical problems in the classification of investment data involving the treatment of grants to State and local governments and the classification of spending that could be shown in more than one category.

First, for some grants to State and local governments it is the recipient jurisdiction, not the Federal Government, that ultimately determines whether the money is used to finance investment or current purposes. This analysis classifies all of the outlays in the category where the recipient jurisdictions are expected to spend most of the money. Hence, the community development block grants are classified as physical investment, although some may be spent for current purposes. General purpose fiscal assistance is classified as current spending, although some may be spent by recipient jurisdictions on physical investment.

Second, some spending could be classified in more than one category of investment. For example, outlays for construction of research facilities finance the acquisition of physical assets, but they also contribute to research and development. To avoid double counting, the outlays are classified in the category that is most commonly recognized as investment. Consequently, outlays for the conduct of research and development do not include outlays for research facilities, because these outlays are included in the category for physical investment. Similarly, spending for physical investment and research and development related to education and training is included in the categories of physical assets and the conduct of research and development.

When direct loans and loan guarantees are used to fund investment, the subsidy value is included as investment. The subsidies are classified according to their program purpose, such as construction or education and training. For more information about the treatment of Federal credit programs, refer to Chapter 7, "Credit and Insurance," in this volume.

This section presents spending for gross investment, without adjusting for depreciation.

Composition of Federal Investment Outlays

Major Federal Investment

The composition of major Federal investment outlays is summarized in Table 6–1. They include major public physical investment, the conduct of research and development, and the conduct of education and training. Defense and nondefense investment outlays were $392.3 billion in 2005. They are estimated to increase to $425.0 billion in 2006 and are projected to decline to $415.5 billion in 2007. Major Federal investment outlays will comprise an estimated 15 percent of total Federal outlays in 2007 and 3.0 percent of the Nation's gross domestic product. Greater detail on Federal investment is available in Table 6–2 at the end of this section. That table includes both budget authority and outlays.

Physical investment. Outlays for major public physical capital investment (hereafter referred to as physical investment outlays) are estimated to be $199.3 billion in 2007. Physical investment outlays are for construction and rehabilitation, the purchase of major equipment, and the purchase or sale of land and structures. More than three-fifths of these outlays are for direct physical investment by the Federal Government, with the remainder being grants to State and local governments for physical investment.

Direct physical investment outlays by the Federal Government are primarily for national defense. Defense outlays for physical investment are estimated to be $99.2 billion in 2007. Almost all of these outlays, or an estimated $90.2 billion, are for the procurement of weapons and other defense equipment, and the remainder is primarily for construction on military bases, family housing for military personnel, and Department of Energy defense facilities.

Outlays for direct physical investment for nondefense purposes are estimated to be $30.3 billion in 2007. These outlays include $17.3 billion for construction and rehabilitation. This amount includes funds for water, power, and natural resources projects of the Corps of Engineers, the Bureau of Reclamation within the Department of the Interior, and the Tennessee Valley Authority; construction and rehabilitation of veterans hospitals and Indian Health Service hospitals and clinics; facilities for space and science programs; Postal Service facilities; and construction for embassy security. Outlays for the acquisition of major equipment are estimated to be $12.6 billion in 2007. The largest amounts are for the air traffic control system.

Grants to State and local governments for physical investment are estimated to be $69.9 billion in 2007. More than two-thirds of these outlays, or $50.7 billion, are to assist States and localities with transportation infrastructure, primarily highways. Other major grants for physical investment fund sewage treatment plants, community and regional development, and public housing.

Conduct of research and development. Outlays for the conduct of research and development are estimated to be $130.7 billion in 2007. These outlays are devoted to increasing basic scientific knowledge and promoting research and development. They increase the Nation's security, improve the productivity of capital and labor for both public and private purposes, and enhance the quality of life. More than half of these outlays, an estimated $76.8 billion, are for national defense. Physical investment for research and development facilities and equipment is included in the physical investment category.

Nondefense outlays for the conduct of research and development are estimated to be $53.9 billion in 2007. These are largely for the National Aeronautics and Space Administration, the National Science Foundation, the National Institutes of Health, and research for nuclear and non-nuclear energy programs.

A more complete and detailed discussion of research and development funding appears in Chapter 5, "Research and Development," in this volume.

Conduct of education and training. Outlays for the conduct of education and training are estimated to be $85.5 billion in 2007. These outlays add to the stock of human capital by developing a more skilled and productive labor force. Grants to State and local governments for this category are estimated to be $52.6 billion in 2007, more than three-fifths of the total. They include education programs for the disadvantaged and individuals with disabilities, other education programs, training programs in the Department of Labor, and Head Start. Direct Federal education and training outlays are estimated to be $32.9 billion in 2007. Programs in this category are primarily aid for higher education through student financial assistance, loan subsidies, the veterans GI bill, and health training programs. The decline from 2006 to 2007 results in part from upward reestimates of $11.4 billion in 2006 in loan subsidies for loans made in earlier years.

This category does not include outlays for education and training of Federal civilian and military employees. Outlays for education and training that are for physical investment and for research and development are in

Table 6–1. COMPOSITION OF FEDERAL INVESTMENT OUTLAYS

(In billions of dollars)

	2005 Actual	Estimate	
		2006	2007
Major public physical capital investment:			
Direct Federal:			
National defense	89.5	97.3	99.2
Nondefense	27.3	30.2	30.3
Subtotal, direct major public physical capital investment	116.8	127.5	129.5
Grants to State and local governments	60.8	65.9	69.9
Subtotal, major public physical capital investment	177.7	193.4	199.3
Conduct of research and development:			
National defense	70.6	75.6	76.8
Nondefense	49.2	51.8	53.9
Subtotal, conduct of research and development	119.8	127.4	130.7
Conduct of education and training:			
Grants to State and local governments	51.6	53.7	52.6
Direct Federal	43.2	50.5	32.9
Subtotal, conduct of education and training	94.7	104.2	85.5
Total, major Federal investment outlays	**392.3**	**425.0**	**415.5**
MEMORANDUM			
Major Federal investment outlays:			
National defense	160.1	172.9	176.0
Nondefense	232.1	252.1	239.5
Total, major Federal investment outlays	392.3	425.0	415.5
Miscellaneous physical investment:			
Commodity inventories	–0.7	–0.8	–0.2
Other physical investment (direct)	2.8	3.2	3.3
Total, miscellaneous physical investment	2.1	2.4	3.1
Total, Federal investment outlays, including miscellaneous physical investment	394.4	427.4	418.6

the categories for physical investment and the conduct of research and development.

Miscellaneous Physical Investment

In addition to the categories of major Federal investment, several miscellaneous categories of investment outlays are shown at the bottom of Table 6–1. These items, all for physical investment, are generally unrelated to improving Government operations or enhancing economic activity.

Outlays for commodity inventories are primarily for the purchase or sale of agricultural products pursuant to farm price support programs. Sales are estimated to exceed purchases by $0.2 billion in 2007.

Outlays for other miscellaneous physical investment are estimated to be $3.3 billion in 2007. This category includes primarily conservation programs. These are entirely direct Federal outlays.

Detailed Table on Investment Spending

The following table provides data on budget authority as well as outlays for major Federal investment divided according to grants to State and local governments and direct Federal spending. Miscellaneous investment is not included because it is generally unrelated to improving Government operations or enhancing economic activity.

Table 6–2. FEDERAL INVESTMENT BUDGET AUTHORITY AND OUTLAYS: GRANT AND DIRECT FEDERAL PROGRAMS

(in millions of dollars)

Description	Budget Authority			Outlays		
	2005 Actual	2006 Estimate	2007 Estimate	2005 Actual	2006 Estimate	2007 Estimate
GRANTS TO STATE AND LOCAL GOVERNMENTS						
Major public physical investments:						
Construction and rehabilitation:						
Transportation:						
Highways	38,184	37,806	41,370	31,433	33,868	38,027
Mass transportation	8,039	8,482	8,729	7,826	8,338	8,932
Air transportation	3,696	3,070	2,725	3,530	3,800	3,705
Subtotal, transportation	49,919	49,358	52,824	42,789	46,006	50,664
Other construction and rehabilitation:						
Pollution control and abatement	2,233	1,880	1,759	2,021	1,755	1,706
Community and regional development	6,115	16,779	3,624	6,399	8,251	8,157
Housing assistance	6,505	6,203	5,593	7,687	7,776	7,435
Other construction	496	491	291	458	621	416
Subtotal, other construction and rehabilitation	15,349	25,353	11,267	16,565	18,403	17,714
Subtotal, construction and rehabilitation	65,268	74,711	64,091	59,354	64,409	68,378
Other physical assets	1,567	1,422	1,369	1,494	1,502	1,504
Subtotal, major public physical capital	66,835	76,133	65,460	60,848	65,911	69,882
Conduct of research and development:						
Agriculture	273	277	245	274	268	270
Other	223	226	203	212	194	178
Subtotal, conduct of research and development	496	503	448	486	462	448
Conduct of education and training:						
Elementary, secondary, and vocational education	37,169	37,814	36,381	36,393	38,164	37,689
Higher education	506	701	35	522	809	505
Research and general education aids	800	763	691	753	832	694
Training and employment	3,509	3,125	3,770	3,378	3,077	3,180
Social services	10,145	10,115	9,574	9,861	10,134	9,845
Agriculture	451	456	436	441	452	437
Other	249	242	245	226	234	229
Subtotal, conduct of education and training	52,829	53,216	51,132	51,574	53,702	52,579
Subtotal, grants for investment	120,160	129,852	117,040	112,908	120,075	122,909
DIRECT FEDERAL PROGRAMS						
Major public physical investment:						
Construction and rehabilitation:						
National defense:						
Military construction and family housing	8,190	9,172	8,537	6,150	7,431	8,309
Atomic energy defense activities and other	527	634	676	663	585	690
Subtotal, national defense	8,717	9,806	9,213	6,813	8,016	8,999
Nondefense:						
International affairs	1,922	1,330	1,450	1,436	1,276	1,343
General science, space, and technology	1,946	2,066	2,089	1,799	2,161	2,897
Water resources projects	3,318	4,316	2,692	2,749	4,040	3,402
Other natural resources and environment	969	974	810	988	1,021	935
Energy	1,309	1,468	1,281	1,307	1,435	1,296
Postal Service	708	1,118	1,698	678	677	1,103
Transportation	122	130	112	93	194	160
Veterans hospitals and other health facilities	2,133	2,371	1,655	1,618	1,851	1,941
Federal Prison System	25	49	–116	260	117	123
GSA real property activities	1,627	1,676	1,556	1,407	1,689	1,882
Other construction	2,617	2,541	1,989	2,538	2,551	2,207
Subtotal, nondefense	16,696	18,039	15,216	14,873	17,012	17,289

Table 6–2. FEDERAL INVESTMENT BUDGET AUTHORITY AND OUTLAYS: GRANT AND DIRECT FEDERAL PROGRAMS—Continued

(in millions of dollars)

Description	Budget Authority			Outlays		
	2005 Actual	2006 Estimate	2007 Estimate	2005 Actual	2006 Estimate	2007 Estimate
Subtotal, construction and rehabilitation	25,413	27,845	24,429	21,686	25,028	26,288
Acquisition of major equipment:						
National defense:						
Department of Defense	96,695	86,185	84,328	82,298	88,802	89,769
Atomic energy defense activities	381	473	473	388	470	456
Subtotal, national defense	97,076	86,658	84,801	82,686	89,272	90,225
Nondefense:						
General science and basic research	597	583	768	604	591	709
Space flight, research, and supporting activities	1,179	360	426	956	272	405
Postal Service	881	1,124	762	552	740	851
Air transportation	3,183	3,181	2,862	2,644	2,728	2,591
Water transportation (Coast Guard)	990	1,147	1,124	816	991	1,144
Other transportation (railroads)	1,207	1,293	900	1,221	1,330	900
Hospital and medical care for veterans	1,091	886	1,009	776	1,022	130
Law enforcement activities	1,717	1,798	1,948	1,684	1,628	1,846
Department of the Treasury (fiscal operations)	259	237	216	296	228	227
Department of Commerce (NOAA)	896	923	962	908	773	952
GSA general services funds	826	906	906	791	784	792
Other	837	2,035	2,071	785	1,775	2,078
Subtotal, nondefense	13,663	14,473	13,954	12,033	12,862	12,625
Subtotal, acquisition of major equipment	110,739	101,131	98,755	94,719	102,134	102,850
Purchase or sale of land and structures:						
National defense	–25	–28	–28	–25	–28	–28
Natural resources and environment	152	134	80	232	164	123
General government	161	168	164	158	168	164
Other	76	53	85	53	31	63
Subtotal, purchase or sale of land and structures	364	327	301	418	335	322
Subtotal, major public physical investment	136,516	129,303	123,485	116,823	127,497	129,460
Conduct of research and development:						
National defense:						
Defense military	69,608	71,860	74,213	66,467	71,572	72,871
Atomic energy and other	3,942	3,780	3,787	4,179	4,052	3,967
Subtotal, national defense	73,550	75,640	78,000	70,646	75,624	76,838
Nondefense:						
International affairs	255	255	255	258	258	258
General science, space, and technology:						
NASA	6,883	8,309	9,378	6,880	7,143	8,807
National Science Foundation	3,759	3,797	4,066	3,638	3,823	3,833
Department of Energy	2,832	2,890	3,246	2,809	2,900	3,246
Subtotal, general science, space, and technology	13,729	15,251	16,945	13,585	14,124	16,144
Energy	1,162	1,301	1,438	1,272	1,478	1,337
Transportation:						
Department of Transportation	507	657	509	444	706	628
NASA	954	929	721	834	812	802
Other	17	17	13	10	12	16
Subtotal, transportation	2,640	2,904	2,681	2,560	3,008	2,783
Health:						
National Institutes of Health	27,445	27,683	27,712	26,039	26,634	27,499
All other health	691	710	691	707	705	686
Subtotal, health	28,136	28,393	28,403	26,746	27,339	28,185

Table 6–2. FEDERAL INVESTMENT BUDGET AUTHORITY AND OUTLAYS: GRANT AND DIRECT FEDERAL PROGRAMS—Continued

(in millions of dollars)

Description	Budget Authority			Outlays		
	2005 Actual	2006 Estimate	2007 Estimate	2005 Actual	2006 Estimate	2007 Estimate
Agriculture	1,533	1,577	1,353	1,484	1,494	1,311
Natural resources and environment	2,104	2,089	1,972	1,854	2,069	1,898
National Institute of Standards and Technology	394	354	361	418	368	421
Hospital and medical care for veterans	742	765	765	714	738	744
All other research and development	1,625	1,950	1,903	1,353	2,177	1,932
Subtotal, nondefense	50,903	53,283	54,383	48,714	51,317	53,418
Subtotal, conduct of research and development	124,453	128,923	132,383	119,360	126,941	130,256
Conduct of education and training:						
Elementary, secondary, and vocational education	1,605	1,314	1,153	1,706	1,851	1,389
Higher education	31,756	45,512	22,359	31,482	39,332	21,477
Research and general education aids	1,880	1,900	1,962	1,954	1,988	1,942
Training and employment	1,626	328	1,366	1,652	458	1,346
Health	1,555	1,365	1,030	1,465	1,401	1,253
Veterans education, training, and rehabilitation	2,833	3,339	3,292	2,970	3,292	3,443
General science and basic research	904	898	920	919	936	924
National defense	8	....	....	9	....	....
International affairs	406	455	503	423	421	475
Other	616	644	569	584	830	649
Subtotal, conduct of education and training	43,189	55,755	33,154	43,164	50,509	32,898
Subtotal, direct Federal investment	304,158	313,981	289,022	279,347	304,947	292,614
Total, Federal investment	424,318	443,833	406,062	392,255	425,022	415,523

PART II: PERFORMANCE OF FEDERAL INVESTMENT

Introduction. In recent years there has been increased emphasis on improving the performance of Government programs. This emphasis began with the Government Performance and Results Act of 1993, which requires agencies to prepare strategic plans and annual performance plans, and then report on their actual performance annually.

This Administration set out to ensure that agencies worked to improve their performance, not just report on it. Beginning in the 2004 Budget, the Administration began to assess every Federal program by a method known as the Program Assessment Rating Tool, or PART. The Administration set a target of assessing all Federal programs over five years. With this budget, the fourth year of using the PART, the Administration has assessed almost 800 programs, about four-fifths of the Federal budget.

The PART assesses each program in four components (purpose, planning, management, and results/accountability) and gives a score for each of the components. The scores for each component are then weighted—results/accountability carries the greatest weight—and the program is given an overall score. A program is rated Effective if it receives an overall score of 85 percent or more, Moderately Effective if the score is 70 to 84 percent, Adequate if the score is 50 to 69 percent, and Inadequate if the score is 49 percent or lower. The program may receive a rating "Results Not Demonstrated" if it does not have a good long-term and annual performance measure or does not have data to report on its measures. Chapter 2 of this volume discusses the PART concepts in more detail.

This section summarizes the results of the PART for direct investment programs, defined to include capital assets, research and development, and education and training. Because an entire program is assessed, not just the investment portion of the program, the assessments for some programs may cover more than just the investment spending. PART assessments of programs that are grants to State and local governments are not summarized in this chapter but are summarized in Chapter 8, "Aid to State and Local Governments," in this volume.

This section summarizes 209 programs:

- Programs for capital assets are essentially those identified in the PART system as "capital assets and service acquisition" (79 programs);
- Programs for research and development are essentially those identified in the PART system as "research and development" (102 programs); and
- Programs for education and training (28 programs) are primarily programs in the Department of Education that are not grants to State and local governments (e.g., Federal Pell Grants). This cat-

egory also includes programs in other agencies, such as the Montgomery GI Bill in the Department of Veterans Affairs, the Health Professions program in the Department of Health and Human Services, and the Job Corps program in the Department of Labor.

Information on these and other programs assessed by PART is at *www.ExpectMore.gov*.

Summary of ratings. Table 6–3 shows that the average rating for the 209 investment programs that have been rated by PART was "Adequate". These programs had total spending of $227.5 billion in 2005. Of these programs:

- 47 were rated effective ($45.0 billion);
- 67 were rated moderately effective ($69.0 billion);
- 46 were rated adequate ($72.4 billion);
- 9 were rated ineffective ($6.7 billion); and
- 40 were rated "results not demonstrated" ($34.3 billion).

Table 6–3. SUMMARY OF PART RATINGS AND SCORES FOR DIRECT FEDERAL INVESTMENT PROGRAMS

(excludes grants to State and local governments for investment)

Criteria	Type of Investment			
	Physical capital	Research and development	Education and training	All investment programs
	Type of Investment			
Purpose	83%	92%	79%	87%
Planning	79%	83%	73%	80%
Management	82%	87%	67%	83%
Results/Accountability	55%	60%	34%	55%
Average Rating [1]	Adequate	Moderately effective	Adequate	Adequate
	Number of Programs			
Ratings [1]				
Effective	16	29	2	47
Moderately Effective	24	41	2	67
Adequate	18	17	11	46
Ineffective	2	3	4	9
Results Not Demonstrated	19	12	9	40
Total number of investment programs rated	79	102	28	209
	In millions of dollars (2005)			
Effective	$4,658	$39,839	$479	44,976
Moderately Effective	50,825	16,516	1,707	69,048
Adequate	45,064	1,737	25,602	72,403
Ineffective	5,323	166	1,249	6,738
Results Not Demonstrated	27,237	2,149	4,930	34,316
All investment programs that were rated in PART	$133,107	$60,407	$33,967	$227,481

[1] Ratings are determined by weighting the section scores a follows: Purpose (20 percent), Planning (10 percent), Management (20 percent), Results/Accountability (50 percent). The resulting weighted average is translated into a rating: Effective indicates a score of 85 percent or more; Moderately Effective, 70–84 percent; Adequate, 50–69 percent; and Ineffective, 49 percent or less. Regardless of the weighted average, a rating of Results Not Demonstrated may be given if the program does not have performance goals or has not collected data on its performance goals.

Assessments of individual programs. The ratings of the ten physical capital and education and training investment programs with the largest funding are summarized here. Information on research and development is in Chapter 5, "Research and Development" in this volume.

Capital Assets

Department of Defense. Navy Shipbuilding ($13.4 billion in 2005). Rating: *Adequate*.

This program buys new ships and overhauls existing ships. New ships are built at six privately-owned shipyards. Overhauls of existing ships are performed at both privately-owned and publicly-owned shipyards. The Navy currently has 280 ships in the fleet. The Navy conducts periodic reviews of programs at major milestones of development and uses a structured reporting regime to help monitor the status of ship cost, schedule, and performance.

The Navy has experienced cost increases and schedule slips on some ship construction programs, although overall performance is adequate. For example, the first Virginia Class submarine was only 89 percent complete in 2003 when the target was 92 percent. In addition, the cost of the first Virginia class submarine increased by 24 percent in 2002.

Department of Defense (DoD). Air Combat Program ($13.4 billion in 2005). Rating: *Moderately Effective*. The purpose of this program is to enable DoD to successfully wage war in the air by developing and producing a variety of tactical fighter and strike aircraft. DoD's individual programs within the overall air combat program are delivering aircraft at targeted rates, but in several cases, such as the F/A–22, at greater cost than projected.

DoD is moving towards an assessment of the overall capabilities provided by its programs, rather than its traditional assessment of individual acquisition programs. However, until the air combat program is managed as a single program (consisting of several systems) with clear long-term goals, it will be difficult to perform such a "capabilities based" assessment.

Department of Defense. Marine Corps/Expeditionary Warfare. ($11.9 billion in 2005). Rating: *Results Not Demonstrated*. Expeditionary warfare is the temporary use of Marine Corps force in foreign countries. The expeditionary warfare program consists of specific investment programs for aviation assets, amphibious ships, weapons systems, equipment, vehicles, ammunition, and research and development.

The Department of Defense has not set long-term performance measures to guide program management and budgeting for expeditionary warfare. It does not have program measures that assess the most important aspects of expeditionary warfare and its strategic goals.

Department of Defense. Missile Defense ($8.8 billion in 2005). Rating: *Adequate*. The mission of the Missile Defense Agency (MDA) is to defend the United States, deployed forces, and allies from ballistic missile attack. MDA is researching, developing and fielding a global, integrated and multi-layered Ballistic Missile Defense System (BMDS), comprising multiple sensors, interceptors and battle management capabilities.

MDA's strategic planning, resource allocation and management oversight activities are properly aligned to accomplish stated mission objectives. MDA budget requests and human resource management activities are explicitly tied to appropriate performance goals. MDA leaders regularly review and evaluate a wide array of performance data to inform and guide their decisionmaking.

Tennessee Valley Authority. Tennessee Valley Authority Power ($7.8 billion in 2005). Rating: *Moderately Effective.* TVA is the Nation's largest public power company. Through 158 locally owned distributors, TVA provides power to nearly 8.5 million residents of the Tennessee Valley. Some of TVA's former performance measures such as cents/KWH are no longer tracked. It is unclear how some of the new efficiency measures tracked by TVA relate to program performance. In its strategic plan, the Tennessee Valley Authority committed to a debt reduction plan that will reduce its total debt by $3–$5 billion over a ten-year to twelve-year period. TVA has since increased that debt reduction total to $7.8 billion by 2016.

Department of Defense. Future Combat Systems/ Modularity Land Warfare ($7.4 billion in 2005). Rating: *Moderately Effective.* The Army's complementary transformation initiatives, Modularity and the Future Combat Systems, are designed to provide regional combatant commanders and soldiers with a lighter, faster, more survivable and rapidly deployable force with which to fight and win the United States' current and future land conflicts.

Although the Future Combat Systems program is currently on schedule and on cost, the program's long schedule, significant cost, and technological complexity put Future Combat Systems at substantial risk of cost and schedule overruns as the program moves from research and development to acquisition.

Department of Energy. Environmental Management ($7.3 billion in 2005). Rating: *Adequate*. This program protects human health and the environment by cleaning up millions of gallons of radioactive waste, thousands of tons of spent nuclear fuel and special nuclear material, along with huge quantities of contaminated soil and water.

Managers are implementing reforms that are improving program performance, which will significantly reduce environmental, safety, and health risks. For example, at the Hanford (State of Washington) site, the program continues to expedite retrieval of radioactive waste from leak-prone, single-shell tanks and transfer the waste to double-shell tanks for safer storage until treated and disposed. The program recently completed the physical cleanup of the Rocky Flats (Colorado) site more than a year ahead of schedule and below estimated costs. Most of the site will transfer to the Department of the Interior to manage as a national wildlife refuge after the Environmental Protection Agency, with concurrence by the Colorado Department of Public Health and Environment, certifies that the cleanup meets human health standards.

General Services Administration. National Information Technology Solutions ($6.3 billion in 2005). Rating: *Results Not Demonstrated*. This program provides expert technical, acquisition, and information technology products and services to Federal clients. GSA is reviewing the organization of both the National and Regional IT Solutions programs for possible consolidation.

The assessment found that the program is useful to Federal agencies that do not have in-house expertise to acquire information technology (IT) products or services. However, the program must better demonstrate the value it provides to customer agencies. The program must develop long-term outcome goals and efficiency measures which are comparable to other Federal agencies or the private sector. While the program does have annual goals, it must develop annual goals which measure the savings and quality improvement that agencies achieve through use of this program.

Education

Department of Education. Federal Pell Grants ($12.4 billion in 2005). Rating: *Adequate*. This program helps ensure access to postsecondary education for undergraduate students by providing need-based grants that, in combination with other sources of student aid, help meet education costs. The program also promotes lifelong learning by encouraging low-income adults to return to school.

The program has meaningful performance measures and outcome data on these measures such as the degree to which Pell Grants are targeted to low-income students. New measures such as enrollment and graduation rates among low-income and minority students have also been added. The program has met its current long-term performance goals and new measures will help track other key program goals.

Department of Education. Federal Family Education Loan Program ($11.1 billion (subsidy cost) in 2005). Rating: *Adequate*. This program provides default insurance and interest subsidies to encourage private lenders to make postsecondary education loans to undergraduate and graduate students. The program also provides interest subsidies for eligible low-income students to cover interest accrued while in school.

Overall, the assessment concluded that both this program and the William D. Ford Direct Student Loan program fulfill their purpose of ensuring that low and middle income students can afford the costs of postsecondary education. The two programs combined provide over $70 billion a year in new loans to students. While the PART found that these programs had meaningful performance measures and outcome data, it also found that both programs could be more cost efficient.

PART III: FEDERALLY FINANCED CAPITAL STOCKS

Federal investment spending creates a “stock” of capital that is available in the future for productive use. Each year, Federal investment outlays add to this stock of capital. At the same time, however, wear and tear and obsolescence reduce it. This section presents very rough measures over time of three different kinds of capital stocks financed by the Federal Government: public physical capital, research and development (R&D), and education.

Federal spending for physical assets adds to the Nation’s capital stock of tangible assets, such as roads, buildings, and aircraft carriers. These assets deliver a flow of services over their lifetime. The capital depreciates as the asset ages, wears out, is accidentally damaged, or becomes obsolete.

Federal spending for the conduct of research and development adds to an “intangible” asset, the Nation’s stock of knowledge. Spending for education adds to the stock of human capital by providing skills that help make people more productive. Although financed by the Federal Government, the research and development or education can be carried out by Federal or State government laboratories, universities and other nonprofit organizations, local governments, or private industry. Research and development covers a wide range of activities, from the investigation of subatomic particles to the exploration of outer space; it can be “basic” research without particular applications in mind, or it can have a highly specific practical use. Similarly, education includes a wide variety of programs, assisting people of all ages beginning with pre-school education and extending through graduate studies and adult education. Like physical assets, the capital stocks of R&D and education provide services over a number of years and depreciate as they become outdated.

For this analysis, physical and R&D capital stocks are estimated using the perpetual inventory method. Each year’s Federal outlays are treated as gross investment, adding to the capital stock; depreciation reduces the capital stock. Gross investment less depreciation is net investment. The estimates of the capital stock are equal to the sum of net investment in the current and prior years. A limitation of the perpetual inventory method is that the original investment spending may not accurately measure the current value of the asset created, even after adjusting for inflation, because the value of existing capital changes over time due to changing market conditions. However, alternative methods for measuring asset value, such as direct surveys of current market worth or indirect estimation based on an expected rate of return, are especially difficult to apply to assets that do not have a private market, such as highways or weapons systems.

In contrast to physical and R&D stocks, the estimate of the education stock is based on the replacement cost method. Data on the total years of education of the U.S. population are combined with data on the current cost of education and the Federal share of education spending to yield the cost of replacing the Federal share of the Nation’s stock of education.

It should be stressed that these estimates are rough approximations, and provide a basis only for making broad generalizations. Errors may arise from uncertainty about the useful lives and depreciation rates of different types of assets, incomplete data for historical outlays, and imprecision in the deflators used to express costs in constant dollars. The methods used to estimate capital stocks are discussed further in the technical note at the end of Chapter 13, “Stewardship,” in this volume. Additional detail about these methods appeared in a methodological note in Chapter 7, “Federal Investment Spending and Capital Budgeting,” in the *Analytical Perspectives* volume of the 2004 Budget.

The Stock of Physical Capital

This section presents data on stocks of physical capital assets and estimates of the depreciation of these assets.

Trends. Table 6–4 shows the value of the net federally financed physical capital stock since 1960, in constant fiscal year 2000 dollars. The total stock grew at a 2.2 percent average annual rate from 1960 to 2005, with periods of faster growth during the late 1960s and the 1980s. The stock amounted to $2,257 billion in 2005 and is estimated to increase to $2,381 billion by 2007. In 2005, the national defense capital stock accounted for $680 billion, or 30 percent of the total, and nondefense stocks for $1,577 billion, or 70 percent of the total.

Table 6–4. NET STOCK OF FEDERALLY FINANCED PHYSICAL CAPITAL

(In billions of 2000 dollars)

Fiscal Year	Total	National Defense	Nondefense								
			Total Non-defense	Direct Federal Capital			Capital Financed by Federal Grants				
				Total	Water and Power	Other	Total	Trans-portation	Community and Regional	Natural Resources	Other
Five year intervals:											
1960	849	608	242	95	59	36	146	89	27	21	10
1965	937	589	348	123	74	49	225	158	32	22	13
1970	1,101	630	470	146	88	58	324	230	47	26	21
1975	1,137	545	592	166	102	64	426	282	76	42	25
1980	1,258	494	763	195	123	72	568	342	121	79	27
1985	1,462	572	890	222	136	86	668	397	146	100	26
1990	1,740	722	1,018	256	147	109	762	462	158	113	28
1995	1,882	714	1,168	297	157	141	871	534	168	123	46
Annual data:											
2000	1,979	635	1,345	337	160	178	1,007	618	183	131	75
2001	2,023	631	1,391	351	163	188	1,040	640	186	132	81
2002	2,078	636	1,442	366	165	201	1,076	666	189	134	87
2003	2,138	646	1,492	380	166	213	1,112	690	193	135	94
2004	2,199	662	1,536	391	168	223	1,146	714	196	136	100
2005	2,257	680	1,577	400	168	231	1,178	737	198	138	105
2006 estimate	2,321	700	1,621	410	170	240	1,211	761	202	138	110
2007 estimate	2,381	717	1,664	420	171	249	1,244	786	205	139	114

Real stocks of defense and nondefense capital show very different trends. Nondefense stocks have grown consistently since 1970, increasing from $470 billion in 1970 to $1,577 billion in 2005. With the investments proposed in the budget, nondefense stocks are estimated to grow to $1,664 billion in 2007. During the 1970s, the nondefense capital stock grew at an average annual rate of 5.0 percent. In the 1980s, however, the growth rate slowed to 2.9 percent annually, with growth continuing at about that rate since then.

Real national defense stocks began in 1970 at a relatively high level, and declined steadily throughout the decade as depreciation from investment in the Vietnam era exceeded new investment in military construction and weapons procurement. Starting in the early 1980s, a large defense buildup began to increase the stock of defense capital. By 1987, the defense stock exceeded its earlier Vietnam-era peak. In the early 1990s, however, depreciation on the increased stocks and a slower pace of defense physical capital investment began to reduce the stock from its previous levels. The increased defense investment in the last few years has reversed this decline, increasing the stock from a low of $631 billion in 2001 to $717 billion in 2007.

Another trend in the Federal physical capital stocks is the shift from direct Federal assets to grant-financed assets. In 1960, 39 percent of federally financed nondefense capital was owned by the Federal Government, and 61 percent was owned by State and local governments but financed by Federal grants. Expansion in Federal grants for highways and other State and local capital, coupled with slower growth in direct Federal investment for water resources, for example, shifted the composition of the stock substantially. In 2005, 25 percent of the nondefense stock was owned by the Federal Government and 75 percent by State and local governments.

The growth in the stock of physical capital financed by grants has come in several areas. The growth in the stock for transportation is largely grants for highways, including the Interstate Highway System. The growth in community and regional development stocks occurred largely following the enactment of the community development block grant in the early 1970s. The value of this capital stock has grown only slowly in the past few years. The growth in the natural resources area occurred primarily because of construction grants for sewage treatment facilities. The value of this federally financed stock has increased about 40 percent since the mid-1980s.

The Stock of Research and Development Capital

This section presents data on the stock of research and development capital, taking into account adjustments for its depreciation.

Trends. As shown in Table 6–5, the R&D capital stock financed by Federal outlays is estimated to be $1,106 billion in 2005 in constant 2000 dollars. Roughly half is the stock of basic research knowledge; the remainder is the stock of applied research and development.

The nondefense stock accounted for about three-fifths of the total federally financed R&D stock in 2005. Although investment in defense R&D has exceeded that of nondefense R&D in nearly every year since 1981, the nondefense R&D stock is actually the larger of the two, because of the different emphasis on basic research and applied research and development. Defense R&D spending is heavily concentrated in applied research and development, which depreciates much more quickly than basic research. The stock of applied research and development is assumed to depreciate at a ten percent geometric rate, while basic research is assumed not to depreciate at all.

The defense R&D stock rose slowly during the 1970s, as gross outlays for R&D trended down in constant dollars and the stock created in the 1960s depreciated. Increased defense R&D spending from 1980 through 1990 led to a more rapid growth of the R&D stock. Subsequently, real defense R&D outlays tapered off, depreciation grew, and, as a result, the real net defense R&D stock stabilized at around $420 billion. Renewed spending for defense R&D in recent years has begun to increase the stock, and it is projected to increase to $462 billion in 2007.

The growth of the nondefense R&D stock slowed from the 1970s to the 1980s, from an annual rate of 3.8 percent in the 1970s to a rate of 2.1 percent in the 1980s. Gross investment in real terms fell during much of the 1980s, and about three-fourths of new outlays went to replacing depreciated R&D. Since 1988, however, nondefense R&D outlays have been on an upward trend while depreciation has edged down. As a result, the net nondefense R&D capital stock has grown more rapidly.

Table 6–5. NET STOCK OF FEDERALLY FINANCED RESEARCH AND DEVELOPMENT [1]

(In billions of 2000 dollars)

Fiscal Year	National Defense			Nondefense			Total Federal		
	Total	Basic Research	Applied Research and Development	Total	Basic Research	Applied Research and Development	Total	Basic Research	Applied Research and Development
Five year intervals:									
1970	261	16	245	215	67	148	475	82	393
1975	276	21	256	262	97	165	538	118	421
1980	279	25	255	311	131	179	590	156	434
1985	321	30	291	339	174	165	659	204	455
1990	403	36	367	382	229	154	785	265	520
1995	423	43	380	461	294	167	884	336	547
Annual data:									
2000	423	48	375	543	368	175	966	416	549
2001	421	50	371	563	386	177	984	436	548
2002	420	52	368	587	406	181	1,007	458	549
2003	423	53	370	613	428	186	1,036	481	555
2004	430	54	375	640	450	190	1,070	505	565
2005	439	56	383	666	473	194	1,106	529	577
2006 estimate	451	57	394	692	495	197	1,143	553	591
2007 estimate	462	59	403	718	518	201	1,180	577	603

[1] Excludes stock of physical capital for research and development, which is included in Table 6–4.

The Stock of Education Capital

This section presents estimates of the stock of education capital financed by the Federal Government.

As shown in Table 6–6, the federally financed education stock is estimated at $1,394 billion in 2005 in constant 2000 dollars. The vast majority of the Nation's education stock is financed by State and local governments, and by students and their families themselves. This federally financed portion of the stock represents about 3 percent of the Nation's total education stock.[1] Nearly three-quarters is for elementary and secondary education, while the remainder is for higher education.

[1] For estimates of the total education stock, see table 13–4 in Chapter 13, "Stewardship."

The federally financed education stock has grown steadily in the last few decades, with an average annual growth rate of 5.2 percent from 1970 to 2005. The expansion of the education stock is projected to continue under this budget, with the stock rising to $1,519 billion in 2007.

Table 6–6. NET STOCK OF FEDERALLY FINANCED EDUCATION CAPITAL

(In billions of 2000 dollars)

Fiscal Year	Total Education Stock	Elementary and Secondary Education	Higher Education
Five year intervals:			
1960	71	51	20
1965	102	74	28
1970	233	184	50
1975	347	282	65
1980	479	379	101
1985	575	434	141
1990	730	544	186
1995	874	639	235
Annual data:			
2000	1,136	825	311
2001	1,186	859	327
2002	1,228	891	338
2003	1,277	932	346
2004	1,341	968	373
2005	1,394	1,001	393
2006 estimate	1,462	1,045	417
2007 estimate	1,519	1,086	433

7. CREDIT AND INSURANCE

Federal credit programs offer direct loans and loan guarantees to support a wide range of activities, primarily housing, education, business and community development, and exports. At the end of 2005, there were $247 billion in Federal direct loans outstanding and $1,084 billion in loan guarantees. Through its insurance programs, the Federal Government insures bank, thrift, and credit union deposits, guarantees private defined-benefit pensions, and insures against other risks such as natural disasters.

The Federal Government also enhances credit availability for targeted sectors indirectly through Government-Sponsored Enterprises (GSEs)—privately owned companies and cooperatives that operate under Federal charters. GSEs increase liquidity by guaranteeing and securitizing loans, as well as by providing direct loans. In return for serving social purposes, GSEs enjoy many privileges that differ across GSEs. In general, GSEs can borrow from Treasury in amounts ranging up to $4 billion at Treasury's discretion, GSEs' corporate earnings are exempt from State and local income taxation, GSE securities are exempt from SEC registration, and banks and thrifts are allowed to hold GSE securities in unlimited amounts and use them to collateralize public deposits. These privileges leave many people with the impression that their securities are risk-free. GSEs, however, are not part of the Federal Government, and GSE securities are not federally guaranteed. By law, GSE securities carry a disclaimer of any U.S. obligation.

This chapter discusses the roles of these diverse programs and assesses their effectiveness and efficiency.

- The first section analyzes the roles of Federal credit and insurance programs. Federal programs can play useful roles when market imperfections prevent the private market from efficiently providing credit and insurance. Financial evolution has partly corrected many imperfections and generally weakened the justification for Federal intervention. Federal programs, however, may still be critical in some areas.
- The second section examines how credit and insurance programs were gauged by the Program Assessment Rating Tool (PART) and interprets the PART results.
- The third section discusses individual credit programs and GSEs classified into four sectors: housing, education, business and community development, and exports. The discussion focuses on program objectives, recent developments, performance, and future plans for each program.
- In a similar format, the final section reviews Federal deposit insurance, pension guarantees, disaster insurance, and insurance against terrorism and other security-related risks.

I. FEDERAL PROGRAMS IN CHANGING FINANCIAL MARKETS

The Federal Role

In most cases, private lending and insurance companies efficiently meet economic demands by allocating resources to the most productive uses. Market imperfections, however, can cause inadequate provision of credit or insurance in some sectors. Federal credit and insurance programs improve economic efficiency if they effectively fill the gaps created by market imperfections. On the other hand, Federal credit and insurance programs that have little to do with correcting market imperfections may be ineffective, or can even be counter-productive; they may simply do what the private sector would have done in their absence, or interfere with what the private sector would have done better. Federal credit and insurance programs also help disadvantaged groups. This role alone, however, may not be enough to justify credit and insurance programs. For the purpose of helping disadvantaged groups, direct subsidies are generally more effective and less distortionary.

Relevant market imperfections include insufficient information, limited ability to secure resources, imperfect competition, and externalities. The presence of a market imperfection suggests a possibility that a well-designed Government program can improve on the market outcome, although it does not necessarily mean that Government intervention is desirable. Addressing a market imperfection is a complex and difficult task.

Insufficient Information. Financial intermediaries may fail to allocate credit to the most deserving borrowers if there is little objective information about borrowers. Some groups of borrowers, such as start-up businesses and start-up farmers, have limited incomes and credit histories. Many creditworthy borrowers belonging to these groups may fail to obtain credit or be forced to pay excessively high interest. For very irregular events, such as natural and man-made disasters, there may not be sufficient information to estimate the probability and magnitude of the loss. This pricing difficulty may prevent insurers from covering those risks at reasonable premiums.

Limited Ability to Secure Resources. The ability of private entities to absorb losses is more limited than that of the Federal Government, which has general taxing authority. For some events potentially involving a very large loss concentrated in a short time period, therefore, Government insurance commanding more resources can be more credible and effective. Such events include massive bank failures and some natural and man-made disasters that can threaten the solvency of private insurers.

Imperfect Competition. Competition can be imperfect in some markets because of barriers to entry or economies of scale. Imperfect competition may result in higher prices of credit and insurance in those markets.

Externalities. Decisions at the individual level are not socially optimal when individuals do not capture the full benefit (positive externalities) or bear the full cost (negative externalities) of their activities. Examples of positive and negative externalities are education and pollution. The general public benefits from the high productivity and good citizenship of a well-educated person and suffers from pollution. Without Government intervention, people will engage less than socially optimal in activities that generate positive externalities and more in activities that generate negative externalities.

Effects of Changing Financial Markets

Financial markets have become much more efficient thanks to technological advances and financial services deregulation. By facilitating the gathering and processing of information and lowering transaction costs, technological advances have significantly contributed to improving the screening of credit and insurance applicants, enhancing liquidity, refining risk management, and spurring competition. Deregulation, represented by the Riegle-Neal Interstate Banking and Branching Act of 1997 and the Financial Services Modernization Act of 1999, has increased competition and prompted consolidation by removing geographic and industry barriers.

These changes have reduced market imperfections and hence weakened the role of Federal credit and insurance programs. The private market now has more information and better technology to process it; it has better means to secure resources; and it is more competitive. As a result, the private market is more willing and able to serve a portion of the population traditionally targeted by Federal programs. The benefits of technological advances and deregulation, however, have been uneven across sectors and populations. To remain effective, therefore, Federal credit and insurance programs need to focus more narrowly on those sectors that have been less affected by financial evolution and those populations that still have difficulty in obtaining credit or insurance from private lenders. The Federal Government also needs to pay more attention to new challenges introduced by financial evolution and other economic developments. Even those changes that are beneficial overall often bring new risks and challenges.

The Federal role of alleviating the information problem is generally not as important as it once was. Nowadays, lenders and insurers have easy access to large databases, powerful computing devices, and sophisticated analytical models. This advancement in communication and information processing technology enables lenders to evaluate the risk of borrowers more objectively and accurately. As a result, creditworthy borrowers are less likely to be turned down, while high-risk borrowers are less likely to be approved for credit. The improvement, however, may be uneven across sectors. Credit scoring (an automated process that converts relevant borrower characteristics into a numerical score indicating creditworthiness), for example, is considered as a breakthrough in borrower screening. While credit scoring is widely applied to home mortgages and consumer loans, it is applied to a limited extent for small business loans and agricultural loans due to the difficulty of standardizing unique characteristics of small businesses and farmers. With technological advances, such as computer simulation, pricing catastrophe risks has become easier, but it remains much more difficult than pricing more regular events such as automobile accidents. It is still difficult for insurers to estimate the probability of a major natural disaster occuring. The difficulty may be greater for man-made disasters that lack scientific bases.

Financial evolution has also alleviated resource constraints faced by private entities. Advanced financial instruments have enabled insurers to manage risks more effectively and secure needed funds more easily. Thus, it is less likely that a large potential loss discourages an insurer from offering an actuarially fair contract. Financial derivatives, such as options, swaps, and futures, have improved the market's ability to manage and share various types of risk such as price risk, interest rate risk, credit risk, and even catastrophe-related risk. An insurer can distribute the risk of a natural or man-made catastrophe among a large number of investors through catastrophe-related derivatives. The extent of risk sharing in this way, however, is still limited because of the small size of the market for those products.

Imperfect competition, one possible motivation for Government intervention, is much less likely in general, thanks to financial deregulation and improved communication and financing technology. Financial deregulation removed geographic and industry barriers to competition. As a result, major financial holding companies offer both banking and insurance products nationwide. Internet-based financial services have lowered the cost of financial transactions and reduced the importance of physical location. These developments have been particularly more beneficial to small and geographically isolated customers, as lower transaction costs make it easier to offer good prices to small customers. Securitization (pooling a certain type of asset and selling shares of the asset pool to investors) facilitates fund raising and risk management. By securitizing loans, small lenders with limited access to capital can more effectively compete with large ones. In addition, there are more financing alternatives for both commercial and individual borrowers that used to rely heavily on banks. Many commercial firms borrow directly in capital markets, bypassing financial intermediaries; the use of commercial paper (short-term financing instruments issued by corporations) has been particularly notable. Venture capital has become a much more important financing source for small businesses. Finance companies have gained market shares both in business and consumer financing.

Problems related to externalities may persist because the price mechanisms that drive the private market ignore the value of externalities. Externalities, however, are a general market failure, rather than a financial market failure. Thus, credit and insurance programs are not necessarily the best means to address externalities, and their effectiveness should be compared with other forms of Government intervention, such as tax incentives and grants. In particular, if a credit program was initially intended to address multiple problems, including externalities, and those other problems have been alleviated, there may be a better way to address remaining externalities.

Overall, the financial market has become more efficient and safer. Financial evolution and other economic developments, however, are often accompanied by new risks. Federal agencies need to be vigilant to identify and manage new risks to the Budget. For example, financial derivatives enable their users either to decrease or to increase risk exposure. If some beneficiaries of Federal programs use financial derivatives to take more risk, the costs of Federal programs, especially insurance programs, can rise sharply. The sheer size of some financial institutions has also created a new risk. While well-diversified institutions are generally safer, even a single failure of a large private institution or a GSE, such as Fannie Mae, Freddie Mac, and Federal Home Loan Banks, could shake the entire financial market. A more visible risk today is posed by the Pension Benefit Guaranty Corporation (PBGC) of the Department of Labor. PBGC is facing serious financial challenges due to unfavorable developments in recent years and to flaws in program structure that the Administration has proposed to remedy.

Security-related risks heightened after the September 11th attacks also pose a challenge. Insurance programs covering security-related risks, such as terrorism and war, are difficult to manage because those events are highly uncertain in terms of both the frequency of occurrence and the magnitude of potential loss.

II. PERFORMANCE OF CREDIT AND INSURANCE PROGRAMS

The Program Assessment Rating Tool (PART) is a performance evaluation tool designed to be consistent across Federal programs. This section analyzes the PART score for credit and insurance programs as a group to identify the strengths and weaknesses of credit and insurance programs.

PART Scores

The PART evaluates programs in four areas (program purpose and design, strategic planning, program management, and program results) and assigns a numerical score (0 to 100) to each category. The overall rating (effective, moderately effective, adequate, ineffective, or results not demonstrated) is determined based on the numerical scores and the availability of reliable data.

There are 30 credit programs (defined as those involving repayment obligations) and 5 insurance programs among 795 programs that have been rated by the PART. When appropriately weighted, the overall average score for credit and insurance programs is similar to that for other programs (see Table "Summary of PART Scores"). The ratings for credit and insurance programs, however, are more clustered around the middle. Most credit and insurance programs (77 percent, compared with 55 percent for other programs) are rated "adequate" or "moderately effective," while only 2 programs (6 percent, compared with 16 percent for other programs) are rated "effective." These results suggest that most credit and insurance programs meet basic standards, but need to improve.

Looking across evaluation criteria, for both credit and insurance programs and other programs, the scores are high in program purpose and design and in program management, while low in program results. Relative to other programs, however, credit and insurance programs scored low in program purpose and design and high in program results.

SUMMARY OF PART SCORES

	Purpose and Design	Strategic Planning	Program Management	Program Results
Credit and Insurance Programs				
Average	77.1	69.4	84.8	53.0
Standard Deviation	20.4	23.6	19.6	18.1
All Others Excluding Credit and Insurance Programs				
Average	86.3	73.4	81.4	47.1
Standard Deviation	19.3	25.2	18.0	26.6

The PART indicates that most credit and insurance programs have clear purposes (not necessarily economically justifiable purposes) and address specific needs. Many credit and insurance programs, however, fail to score high in program design. Some are duplicative of other federal programs or private sources, and some have flawed designs, such as inadequate incentive structures, limiting their effectiveness and efficiency.

Regarding strategic planning, credit and insurance programs show strengths in accomplishing short-term goals. Weaknesses are found in pursuing long-term performance goals, conducting stringent performance evaluation, and tying budgets to performance outcomes. Many programs, however, have taken meaningful steps to correct their strategic planning deficiencies.

In the program management category, credit and insurance programs are strong in basic financial and accounting practices, such as spending funds for intended purposes, and in collaborating with related programs. However, some programs show weaknesses in more sophisticated financial management, such as evaluating risks—a critical skill for the effective management of credit and insurance programs.

Program results, the most important category of performance, are a weak area for credit and insurance programs despite a higher average score than that of other programs. In particular, many credit and insurance programs lack objectives evidences of program effectiveness and achieving results. This finding points to a strong need for results-driven management.

Common Features

There are some key features that distinguish credit and insurance programs from other programs. Credit and insurance programs are intended to address imperfections in financial markets. They also face various risks, such as uncertain default rates and erratic claim rates. Understanding common features in relation to the PART should help to interpret PART results and to devise adequate steps to improve performance.

Program Purpose and Design. The most important role of credit and insurance programs is to serve those target populations that are not effectively served by the private sector. Financial markets, however, have been evolving to serve those populations better. Thus, to refocus programs appropriately, it is important to examine the effect of financial evolution.

Lending and insurance are complex businesses involving screening applicants, financing, servicing, and monitoring. Given these complexities, the Government can significantly benefit from partnership with the private sector that combines the Government's and private entities' strengths. It takes a careful program design to realize the potential benefit from such partnership. In particular, the private partner's profit should be closely tied to its contribution to the program's effectiveness and efficiency. Without proper incentives, private entities do not perform as intended. For example, private lenders are generally better at screening borrowers, but they may not screen borrowers effectively if the Government provides a 100-percent loan guarantee.

Strategic Planning. Financial markets change rapidly, and credit and insurance programs need to adapt to new developments quickly. For example, adopting new technologies is important. Private lenders are increasingly applying advanced technologies to credit evaluation. Falling behind, Federal credit programs can be left with much riskier borrowers as private entities attract better-risk borrowers away from Federal programs.

Program Management. Risk management is a critical element of credit and insurance programs. The cashflow is uncertain both for credit and insurance programs. The default rate and the claim rate can turn out to be significantly different than expected. Credit programs also face prepayment and interest rate risks. These risks must be carefully managed to ensure that the program cost stays within a reasonable range. Effective risk management requires that program managers thoroughly understand the characteristics of beneficiaries and vigilantly monitor new developments. Given these needs for accurate and timely information, collecting and processing data may be more important for credit and insurance programs than for most other programs.

Program Results. The main difficulty in evaluating program performance is measuring the net outcome of the program (improvement in the intended outcome net of what would have occurred in the absence of the program). Suppose that an education program is intended to increase the number of college graduates. Although it is straightforward to measure the number of college graduates who were assisted by the program, it is difficult to tell how many of those would not have obtained a college degree without the program's assistance. Credit and insurance programs face an additional difficulty of estimating the program cost accurately. In evaluating programs, the outcome must be weighed against the cost. In the above example, the ultimate measure of effectiveness is not the net number of college graduates produced by the program but the net number per Federal dollar spent on the program. Thus, an inaccurate cost estimation would lead to incorrect program evaluation; an underestimation (overestimation) of the cost would make the program appear unduly effective (ineffective). Results for credit and insurance programs need to be interpreted in conjunction with the accuracy of cost estimation.

The net outcome of a credit or an insurance program can change quickly because it depends on the state of financial markets, which are very dynamic. The net outcome can decrease, as private entities become more willing to serve those customers whom they were reluctant to serve in the past, or it can increase if financial markets fail to function smoothly due to some temporary disturbances. Thus, the effect of financial evolution needs to be analyzed carefully. A sub-par performance by a credit program could be related to financial market developments; the program might have

President's Management Agenda Program Initiative: Improved Credit Management

As one of the world's largest lenders, with a portfolio of more than $1.3 trillion in outstanding direct loans and loan guarantees, the Federal Government has a great interest in efficient risk management. This need is even stronger when considered in the context of the Government's target borrower population: those whose risk profiles prevent them from obtaining private credit on reasonable terms. Given the higher default probability and the substantial portfolio size, lax management can result in a large increase in the cost to the Government. Thus, the Government must adopt effective risk management techniques to keep defaults in check and increase recoveries when defaults do occur, while still controlling administrative costs.

At the same time, the Government must ensure that it is effectively serving its intended borrowers. While these primary goals may occasionally conflict, agencies can achieve both in large part through effective risk identification, careful portfolio monitoring through information reporting, and tracking administrative costs through the credit lifecycle.

The five major credit agencies (the Departments of Agriculture, Education, Housing and Urban Development, Veterans Affairs, and the Small Business Administration) and Treasury will be included in a new President's Management Agenda initiative to improve credit program management. Agencies will be rated on their performance in the areas of loan origination, servicing and portfolio monitoring, and liquidation/debt collection. This effort will be supported by a Credit Council comprised of the Office of Management and Budget and agency representatives. The Council will identify agency and private sector best practices that can be implemented across the major credit agencies, leading to higher program and management efficiencies, budgetary savings, and improved PART scores.

failed to adapt to rapid changes in financial markets; or its function might have become obsolete due to financial evolution. The program should be restructured in the former case and discontinued in the latter case.

III. CREDIT IN FOUR SECTORS

Housing Credit Programs and GSEs

The Federal Government makes direct loans, provides loan guarantees, and enhances liquidity in the housing market to promote homeownership among low and moderate-income people and to help finance rental housing for low-income people. While direct loans are largely limited to low-income borrowers, loan guarantees are offered to a much larger segment of the population, including moderate-income borrowers. Increased liquidity achieved through GSEs benefits mortgage borrowers in general.

Federal Housing Administration

In June 2002, the President issued America's Homeownership Challenge to increase first-time minority homeowners by 5.5 million through 2010. During the first two and a quarter years since the goal was announced, nearly 2.5 million minority families have become homeowners. The Department of Housing and Urban Development's (HUD's) Federal Housing Administration (FHA) helped almost 450,000 of these first-time minority homebuyers through its loan insurance funds, mainly the Mutual Mortgage Insurance (MMI) Fund. FHA mortgage insurance guarantees mortgage loans that provide access to homeownership for people who lack the traditional financial resources or credit history to qualify for a home mortgage in the conventional marketplace. In 2004, 77.5 percent of FHA-insured loans were to first-time homeowners, and 35.0 percent were to minority homebuyers. In 2005, FHA insured almost $58 billion in purchase and refinance mortgages for more than 478,000 households. Nearly 80 percent of these homebuyers were buying their first homes, almost 100,000 were minorities.

While FHA has been a primary mortgage source for first-time and minority buyers since the 1930s, its loan volume has fallen precipitously in the past three years. This is due in part to lower interest rates that have made uninsured mortgages affordable for more families. Moreover, private lenders—aided by automated underwriting tools that allow them to measure risks more accurately—have expanded lending to people who previously would have had no option but FHA—those with few resources to pay for downpayments and/or weaker credit histories than the private sector considered safe. The development of new products and underwriting approaches has allowed private lenders to offer loans to more homebuyers. While this is a positive development when the private sector is offering favorable terms, some borrowers either end up paying too much or receiving unfair terms.

As private lenders have expanded their underwriting to cover more and more buyers, changes have taken place in the composition of FHA's business. First, the percentage of FHA-insured mortgages with initial loan-to-value (LTV) ratios of 95 percent or higher has increased substantially, from 38.6 percent in 1995 to 80.7 percent in 2005. Second, the percentage of FHA loans with downpayment assistance from seller-finance nonprofit organizations has grown rapidly, from 0.3 percent in 1998 to 31 percent in 2005. Recent studies show that these loans are riskier than those made to borrowers who received downpayment assistance from other sources. In FY 2005, FHA's cumulative default claim rate for its core business is projected to have risen from approximately 8 percent to 10 percent

The FHA single-family mortgage program was assessed in 2005 using the PART rating tool. The assessment found that the program was meeting its statutory objective to serve underserved borrowers while maintaining an adequate capital reserve. However, the program lacked quantifiable annual and long-term performance goals that would measure FHA's ability to achieve its statutory mission. In addition, both the PART assessment and subsequent GAO and IG reports noted that the program's credit model does not accurately predict losses to the insurance fund, and that despite FHA efforts to deter fraud in the program, it has not demonstrated that these steps have reduced such fraud.

In response to these findings, in 2006 FHA will measure its performance against goals, such as the percentage of FHA Single Family loans for first-time and minority homeowners, and performance goals for fraud detection and prevention. While FHA has taken steps to improve the accuracy of its annual actuarial review claim and prepayment estimates, it will continue to develop a credit model that more accurately and reliably predicts claims costs.

Proposals for Program Reform

In order to enable FHA to fulfill its mission in today's changing marketplace, the Administration will introduce legislation that will give FHA the ability to respond to current challenges to homeownership among its traditional target borrowers: low and moderate-income first-time homebuyers. FHA has already taken steps, within its current authority, to streamline its paperwork requirements and remove impediments to its use by lenders and buyers. However, these additional tools will enable it to expand homeownership opportunities to its target borrowers on an actuarially sound basis.

To remove two large barriers to homeownership—lack of savings for a downpayment and impaired credit—the Administration proposes two new FHA mortgage products. The Zero Downpayment mortgage will allow first-time buyers with a strong credit record to finance 100 percent of the home purchase price and closing costs. For borrowers with limited or weak credit histories, a second program, Payment Incentives, will initially charge a higher insurance premium and reduce premiums after a period of on-time payments.

FHA's current nearly flat premium, or fee, structure—charging uniform premiums regardless of the borrower's risk of default as indicated by the percentage of downpayment to the loan amount or borrower credit quality—means that loans to creditworthy borrowers subsidize loans to less creditworthy borrowers. The former may be paying proportionately too much premium, while the latter are paying too little.

For 2007, FHA is proposing to introduce tiered risk-based pricing as a way to more fairly price its guarantee to individual borrowers, and at the same time eliminate the incentive for higher risk borrowers to use FHA because they are undercharged. FHA will base each borrower's mortgage insurance premiums upon the risk that the borrower poses to the FHA mortgage insurance fund. FHA proposes to base its mortgage insurance premiums upon a borrower's consumer credit score from Fair, Isaac, and Company (FICO), amount of downpayment, and source of downpayment (the borrower's own resources, relatives, employer, non-profit organization or public agency). Mortgage insurance premiums will be based on FHA's historical experience with similar borrowers. This change will decrease premiums for many of FHA's traditional borrowers, thereby increasing their access to homeownership.

This price structure has many advantages. First, unlike the subprime market, FHA would price a borrower's risk via the mortgage insurance premium, not in the interest rate. With mortgage insurance, borrowers would pay a market rate of interest, and, as a result, would pay lower monthly payments and lower total costs than they would if they paid a higher mortgage interest rate throughout the life of the loan. Second, using this pricing structure, FHA would promote price transparency. Each borrower would know why they are paying the premium that they are being charged and would know how to lower their borrowing costs—i.e., by raising their FICO score or their downpayment, both matters under their control. Third, using risk-based pricing, FHA could annually review the performance of its programs in conjunction with the preparation of its credit subsidy estimates and could adjust its premiums as necessary to assure the financial soundness of the MMI Fund.

A reformed FHA will adhere to sound management practices that include a new framework of standards and incentives tied to principles of good credit program management. At least annually, FHA will determine the volume and credit subsidy of each product it guarantees. These estimates will determine whether the credit subsidy rate will meet the target credit subsidy rate, and whether policy steps are required to ensure that it does.

To ensure transparency, FHA proposes to run the MMI Fund so that it maintains a target weighted-average credit subsidy rate. To determine the target subsidy rate, FHA will perform probabilistic or scenario analyses to ensure that the reestimated subsidy rate will not exceed an agreed upon upward bound.

The proposed reforms will enable FHA to better meet its objective of serving first-time and low-income home buyers by managing its risks more effectively.

VA Housing Program

The Department of Veterans Affairs (VA) assists veterans, members of the Selected Reserve, and active duty personnel to purchase homes as recognition of their service to the Nation. The program substitutes the Federal guarantee for the borrower's down payment. In 2005, VA provided $23 billion in guarantees to assist 149,399 borrowers.

Since the main purpose of this program is to help veterans, lending terms are more favorable than loans without a VA guarantee. In particular, VA guarantees zero down payment loans. VA provided 84,208 zero down payment loans in 2005.

To help veterans retain their homes and avoid the expense and damage to their credit resulting from foreclosure, VA intervenes aggressively to reduce the likelihood of foreclosures when loans are referred to VA after missing three payments. VA's successful actions resulted in 48.4 percent of such delinquent loans avoiding foreclosure in 2005.

Rural Housing Service

The U.S. Department of Agriculture's Rural Housing Service (RHS) offers direct and guaranteed loans and grants to help very low to moderate-income rural residents buy and maintain adequate, affordable housing. The single-family guaranteed loan program guarantees up to 90 percent of a private loan for low to moderate-income (115 percent of median income or less) rural residents. The programs' emphasis is on reducing the number of rural residents living in substandard housing. In 2005, nearly $4.2 billion in assistance was provided by RHS for homeownership loans and loan guarantees; $3.05 billion of guarantees went to 31,700 households, of which 30 percent went to very low and low-income families (with income 80 percent or less than median area income).

For 2007, RHS will increase the guarantee fee on new 502 guaranteed loans to 3 percent from 2 percent. This allows the loans to be less costly for the Government without a significant additional burden to the borrowers, given that they can finance the fee as part of the loan. This will be coupled with language that will ensure that the RHS guarantee is the only Federal home loan product for which the borrower qualifies. This will ensure that the RHS home loan guarantee program is not redundant with similar home loan guarantee programs at HUD or VA. The guarantee fee for refinance loans remains 0.5 percent. Funding in 2007 is requested at $3.5 billion for purchase loans and $99 million for refinance loans.

RHS programs differ from other Federal housing loan guarantee programs. RHS programs are means-tested and more accessible to low-income, rural residents. In addition, the RHS section 502 direct loans offer assistance to lower-income homeowners by reducing the interest rate down to as low as 1 percent for such borrowers. The section 502 direct program requires graduation to private credit as the borrower's income and equity in their home increase over time. The interest rate depends on the borrower's income. Each loan is reviewed annually to determine the interest rate that should be charged on the loan in that year based on the borrower's projected annual income. The direct program cost is balanced between interest subsidy and defaults. For 2007, RHS expects to provide $1.2 billion in loans with a subsidy rate of 10.03 percent.

RHS offers multifamily housing loans and guarantees to provide rural rental housing, including farm labor housing. Direct loans are provided to construct, rehabilitate, and repair multi-family rural rental housing for very low- and low-income, elderly or handicapped residents as well as migrant farm laborers. To help achieve affordable rents, the interest rate is subsidized to 1 percent. Many very low- and low-income residents' rents are further reduced to 30 percent of their adjusted income through rental assistance grants. For 2007, the request for rental assistance grants is for two-year contracts, down from four years, with a total finding level of $486 million. A two year contract term allows the multifamily housing direct loan program to operate efficiently. Of the total amount requested, $4 million is expected to be used to replenish funds spent for rental assistance for those affected by Hurricane Katrina.

RHS will continue to propose funding and legislative changes to address the preservation issues surrounding the over 40-year old program. A long-term initiative has been developed to revitalize the 17,000-property portfolio. During 2007, $74 million will be directed to the revitalization initiative, primarily to move existing residents in properties leaving the program. No funds are requested for the direct rural rental housing program because fixing the current portfolio is the first priority. The farm labor housing combined grant and loan level will provide $55 million in 2007 for new construction as well as repair and rehabilitation. RHS also guarantees multifamily rental housing loans. RHS expects to be able to guarantee $198 million in loans for 2007.

Government-Sponsored Enterprises in the Housing Market

Between the years 1932–1970, Congress chartered three companies to support the national housing market. These Government-sponsored enterprises ("GSEs") are Fannie Mae, Freddie Mac, and the Federal Home Loan Bank System. (The Federal Home Loan Bank System is comprised of 12 individual banks with shared liabilities.) Together the three enterprises currently support, in one form or another, nearly one-half of all residential mortgages outstanding in the U.S. today. These enterprises are not part of the Federal Government, nor are they fully private. The companies were chartered by Congress with a public mission, and endowed with certain benefits that give them competitive advantages when compared with fully private companies.

The Administration continues to propose broad reform of the supervisory system that oversees Fannie Mae, Freddie Mac, and the Federal Home Loan Bank System. The Administration's reform would establish a new safety and soundness regulator for the housing GSEs with powers comparable to other world-class financial regulators. Comparable authorities include the ability to put a GSE into receivership should it fail, flexible authority to set appropriate capital standards, and ability to mitigate the risks the enterprises currently pose to the financial system and economy.

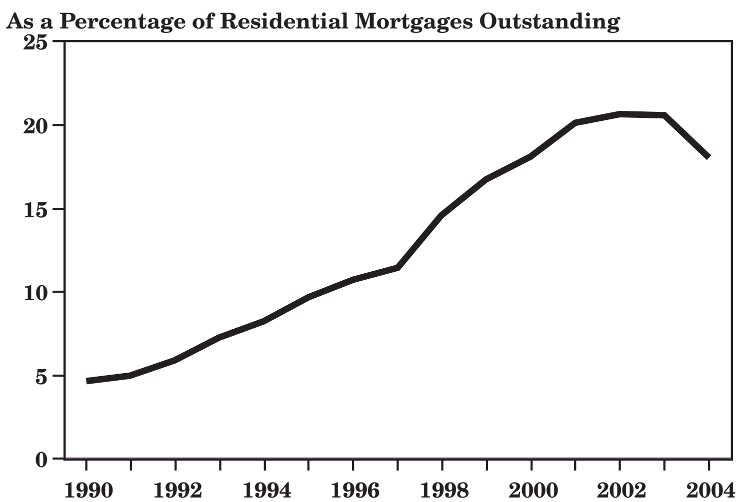
Systemic Risk. Systemic risk is the risk that a failure in one part of the economy could lead to additional failures in other parts of the economy—the risk that a small problem could multiply to a point where it could jeopardize the country's economic well-being. The particular systemic risk posed by the GSEs is the risk that a miscalculation, failure of controls, or other unexpected event at one company could unsettle not only the mortgage markets but other vital parts of the economy. To understand this risk, one must understand the interdependencies among the GSEs and other market participants in the financial system. While the interrelationships of the modern financial system permit highly efficient management and dispersion of risk, these interdependencies, if not disciplined by the regulatory and market environment, may allow a failure in one place to immediately disrupt many other sectors.

The GSEs are among the largest borrowers in the world. Lenders invest in GSE debt securities, and the value of their investment depends on the timely return of their money plus interest. The investors in GSE debt include thousands of banks, thousands of institutional investors such as insurance companies, pension funds, and foreign governments, and millions of individuals through mutual funds and 401k investments. Based on the prices paid by these investors, they act as if there is a legal requirement that the Federal Government guarantees GSE debt. In fact, there is no such guarantee or Federal backing. This perception by investors is reinforced by private ratings agencies in their guidance to investors. For example, recent guidance noted with regard to Fannie Mae and Freddie Mac, "the firms' strategic importance to the US mortgage finance market and global capital markets implies a strong degree of Government support that underpins Moody's Aaa senior unsecured ratings of both housing GSEs."

The market's perception of GSE debt gives the GSEs a competitive advantage over other companies in the housing market, and leads to reduced market discipline. Because investors act as if there is a legal requirement for the Federal Government to back GSE debt, investors on average lend their money to the GSEs at interest rates up to 40 basis points less ($400 less per year for every $100,000 borrowed) than investors lending money to similarly rated, yet fully private, companies. In addition, investors do not demand the same financial disclosures as for fully private companies. Most of the GSEs either have failed to register their securities, or have suspended filing financial statements, with the Securities and Exchange Commission. Yet there has been no significant impact on the pricing of GSE debt securities. This lack of market discipline facilitates the growth of the GSE asset portfolios, thereby increasing systemic risk.

GSE Asset Portfolios. Two of the housing GSEs—Fannie Mae and Freddie Mac—have used their funding advantage to amass large asset portfolios. Together these portfolios are funded by $1.7 trillion in debt. From 1990 through 2004, the GSEs' competitive funding advantage enabled them to build portfolios of mortgage assets at a rate far exceeding the growth of the overall mortgage market, as shown in the graph. In 1990, the GSEs held less than five percent of outstanding mortgages in their asset portfolios. In 2004, they held 18 percent.

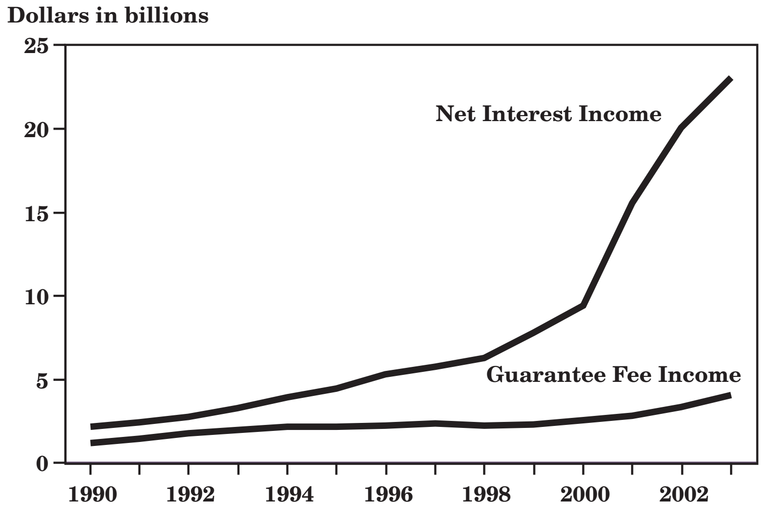
Chart 7-1. Fannie Mae and Freddie Mac Growth of GSE Asset Portfolios



Source: Office of Federal Housing Enterprise Oversight.

In the last decade, the principal source of income for Fannie Mae and Freddie Mac has been net interest on their portfolios. From the 1970s to the early-1990s, Freddie Mac engaged principally in the business of guaranteeing mortgage-backed securities (MBS) for purchase by others, with only a limited mortgage asset portfolio. Although Fannie Mae has always had a mortgage asset portfolio, it was much smaller prior to the last decade. In 2003, the GSEs' income from the MBS guarantee-business represented less than 18 percent of the interest income earned on the asset portfolios. (Income data for Fannie Mae is not available for 2004 due to the pending re-audit and restatement of Fannie Mae's financial statements.)

Chart 7-2. Fannie Mae and Freddie Mac Combined Income



Source: Office of Federal Housing Enterprise Oversight.

The Federal Home Loan Banks have not to date grown mortgage asset portfolios as large as Fannie Mae or Freddie Mac, but the income generated by the mortgage portfolios of the Federal Home Loan Banks has grown since the mid-1990s. Their principal business remains lending to regulated depository institutions and insurance companies engaged in residential mortgage finance. These loans, called advances, are on favorable terms because like Fannie Mae and Freddie Mac, the Federal Home Loan Banks borrow at lower costs than otherwise comparable financial institutions. The Federal Home Loan Banks' advance business carries interest-rate risk, and the Banks must manage this risk.

Thin Capital Cushions. Systemic risk is exacerbated because the GSEs are not required to hold cushions of capital comparable to the capital requirements levied on other large financial institutions.

The three GSEs hold about one-half the capital held by similar, yet fully private, financial institutions. By law, Fannie Mae and Freddie Mac are permitted to borrow $97.50 for every $100 of the asset portfolio, because their capital requirement is only 2.5 percent for these assets. The Federal Home Loan Banks are required to hold about a 4 percent capital cushion, slightly better but still less than that required for commercial banks. Commercial banks must hold a 5 percent capital cushion to be classified as well-capitalized, and generally need additional capital to meet their risk-based capital requirements. In contrast, the risk-based capital requirements for the GSEs have not required additional capital above their minimum capital requirements. These low capital requirements combined with the funding advantage described above have enabled Fannie Mae and Freddie Mac to amass asset portfolios without raising as much capital as other financial institutions, contributing to the GSEs' rate of growth. It also gives them a smaller capital cushion against unexpected changes in the economic environment.

Although the GSEs' mortgage investments are of relatively low default risk, other types of risk in the GSEs' asset portfolios are substantial. Mortgage portfolios carry considerable interest-rate risk, partly because of the prepayment risk caused by the refinance option available on most mortgages that allows homeowners to prepay their mortgages at any time to take advantage of lower interest rates. This risk can be mitigated—for example, through purchase of interest-rate hedges—but the GSEs protect themselves against only some of the interest rate risk of their portfolios. Moreover, hedges are imperfect. Hedging misjudgments would occur even if the GSEs' policy were to fully hedge the portfolio because predicting interest-rate movements and mortgage refinancing activity is difficult. As

GSE asset portfolios have grown in size, the GSEs' participation in the market for hedging instruments has become dominant enough to cause interest rate spikes in the event that a GSE needs to make large and sudden adjustments to its hedging position.

Systemic risk also is exacerbated because financial institutions that lend money to the GSEs may treat these investments favorably. Contrary to their other investments, banks are required to hold only a small amount of capital against the risk of decline in value or failure of the GSE investment. As noted by one rating agency in its guidance to investors, the GSEs have a competitive advantage because financial institutions have virtually no investment limits for GSE debt. Research shows that more than 60 percent of institutions in the banking industry hold as assets GSE debt in excess of half of their equity capital.

Other large financial institutions have more diversified investments, carry less debt relative to their assets, and are subject to disclosure of their business and operations with the Securities and Exchange Commission. In contrast, the GSEs' asset portfolios are highly leveraged, bear significant interest-rate risk, and have a dominant presence in the markets to hedge these risks. These factors, combined with a lack of limits on institutions lending to the GSEs, help explain the systemic risk posed by the GSEs.

GSE Asset Portfolios in the Marketplace. As demonstrated above, the asset portfolios are profit-makers for Fannie Mae and Freddie Mac. In addition, the GSEs claim that their asset portfolios are necessary to maintain a liquid market for their securities and mortgage investments in general. But the market for mortgage-backed securities is robust and liquid, with $250 billion traded daily. The GSEs also claim that their asset portfolios can protect the market in the event of a decline by providing an injection of liquidity. Although the GSEs could use their funding advantage to help limit a market decline by purchasing MBS, it is not necessary for the GSEs to hold an asset portfolio of such investments prior to the decline to provide this liquidity.

The GSEs also claim that by issuing debt to purchase their own mortgage-backed securities, they are attracting foreign investment in the US mortgage market that could not otherwise be gained. But there exists a healthy and growing appetite of foreign investors for mortgage-backed securities, as well as a sophisticated marketplace able to transform mortgage-backed securities into the appealing features of debt securities. In addition, the large amounts of GSE debt may compete to some degree with US Treasury securities, which has the potential to raise the cost of Federal borrowing.

Finally, Fannie Mae and Freddie Mac claim that their asset portfolios expand opportunities for, and lower the cost of, lending to groups traditionally underserved by the private market. These include minority and low-income borrowers. HUD sets annual goals for the GSEs' purchases of mortgages to underserved groups. Meeting HUD's goals, however, does not require the GSEs to hold these mortgages as assets. Most of these mortgages could be securitized and sold to investors, contributing to the expansion of affordable housing as well as any mortgages held by the GSEs.

Mitigating Systemic Risk. The Budget proposes a new strengthened GSE regulator as an independent agency. This proposal and others currently before Congress include differing provisions with respect to the power of a new regulator to require the GSEs to limit the size of their asset portfolios, and to specify under what conditions the regulator should require such a limitation.

Mitigating systemic risk requires taking action before a crisis occurs. Thus a new GSE regulator that is limited in its powers cannot properly mitigate systemic risk. When limited to consideration of the safety and soundness risk of a particular enterprise, for example, the regulator may not fully consider potential consequences to others in the mortgage markets and the larger economy. A world-class regulator for the GSEs must be equipped with the power to limit the systemic risk posed by a GSE before any safety and soundness event at a particular GSE occurs.

Congress can ensure that the GSE asset portfolios do not place the US financial system at risk by instructing a new GSE regulator that asset portfolios are a significant source of systemic risk, and should be limited by the GSE regulator accordingly. This does not mean reducing the size of the mortgage market. The GSEs could still guarantee mortgage-backed securities for sale to other investors. The mortgage market will grow whether mortgages are owned by investors or by the GSEs.

A new regulator with appropriate powers would reduce systemic risk by requiring the GSEs over time to dispose of certain assets, leaving only those that provide a specific public benefit, such as a pipeline for mortgage securitization and affordable housing mortgages not suitable for securitization. These public benefit assets characterize only a small percentage of GSE assets, and thus would decrease the size of the asset portfolios and effectively mitigate the systemic risk posed by the GSEs to the US economy.

Education Credit Programs and GSEs

The Federal Government guarantees loans through intermediary agencies and makes direct loans to students to encourage post-secondary education. The Student Loan Marketing Association (Sallie Mae), created in 1972 as a GSE to develop the secondary market for guaranteed student loans, was privatized in 2004.

The Department of Education helps finance student loans through two major programs: the Federal Family Education Loan (FFEL) program and the William D. Ford Federal Direct Student Loan (Direct Loan) program. Eligible institutions of higher education may participate in one or both programs. Loans are available to students regardless of income. However, borrowers with low family incomes are eligible for loans with additional interest subsidies. For low-income borrowers, the Federal Government subsidizes loan interest costs while borrowers are in school, during a six-month grace period after graduation, and during certain deferment periods.

The FFEL program provides loans through an administrative structure involving over 3,500 lenders, 35 State and private guaranty agencies, roughly 50 participants in the secondary market, and approximately 6,000 participating schools. Under FFEL, banks and other eligible lenders loan private capital to students and parents, guaranty agencies insure the loans, and the Federal Government reinsures the loans against borrower default. Lenders bear two percent of the default risk, and the Federal Government is responsible for the remainder. The Department also makes administrative payments to guaranty agencies and, at certain times, pays interest subsidies on behalf of borrowers to lenders.

The William D. Ford Direct Student Loan program was authorized by the Student Loan Reform Act of 1993. Under the Direct Loan program, the Federal Government provides loan capital directly to more than 1,100 schools, which then disburse loan funds to students. The program offers a variety of flexible repayment plans including income-contingent repayment, under which annual repayment amounts vary based on the income of the borrower and payments can be made over 25 years with any residual balances forgiven.

Last year, the Administration worked to improve the way the loan programs operate by eliminating unnecessary subsidies, expanding risk-sharing to reduce costs, and improving the financial stability of the guaranty agency system. In response, Congress passed reconciliation legislation which will reduce excess subsidies in FFEL and help make both the Direct Loan and FFEL programs more effective. The reforms include a reduction in the percentage of Federal guarantee provided against default in recognition of the strong repayment record for student loans today and an elimination of unnecessary and costly loan subsidy provisions that allowed some loan holders to have exorbitant financial returns on loans funded through tax-exempt securities.

Business and Rural Development Credit Programs and GSEs

The Federal Government guarantees small business loans to promote entrepreneurship. The Government also offers direct loans and loan guarantees to farmers who may have difficulty obtaining credit elsewhere and to rural communities that need to develop and maintain infrastructure. Two GSEs, the Farm Credit System and the Federal Agricultural Mortgage Corporation, increase liquidity in the agricultural lending market.

Small Business Administration

The Small Business Administration (SBA) helps entrepreneurs start, sustain, and grow small businesses. As a "gap lender" SBA works to supplement market lending and provide access to credit where private lenders are reluctant to do so without a Government guarantee. Additionally, SBA assists home and business-owners, as well as renters, cover the uninsured costs of recovery from disasters.

The 2007 Budget requests $436 million, including administrative funds, for SBA to leverage more than $28 billion in financing for small businesses and disaster victims. The 7(a) General Business Loan program will support $17.5 billion in guaranteed loans while the 504 Certified Development Company program will support $7.5 billion in guaranteed loans for fixed-asset financing. SBA will supplement the capital of Small Business Investment Companies (SBICs) with $3 billion in long-term, guaranteed loans for venture capital investments in small businesses. At the end of 2005, the outstanding balance of business loans totaled $63 billion.

SBA seeks to target assistance more effectively to credit-worthy borrowers who would not be well-served by the commercial markets in the absence of a Government guarantee to cover defaults. SBA is actively encouraging financial institutions to increase lending to start-up firms, low-income entrepreneurs, and borrowers in search of financing below $150,000. SBA's outreach for the 7(a) program has been successful. Average loan size has decreased from $232,000 in 2001 to $160,000 in 2005, while the number of small businesses served has grown from 43,000 to 89,000 during the same time period.

Improving management by measuring and mitigating risks in SBA's $63 billion business loan portfolio is one of the agency's greatest challenges. As the agency delegates more responsibility to the private sector to administer SBA guaranteed loans, oversight functions become increasingly important. In the past few years, SBA established the Office of Lender Oversight, which is responsible for evaluating individual SBA lenders. This office employs a variety of analytical techniques to ensure sound financial management by SBA and to hold lending partners accountable for performance. These techniques include portfolio performance analysis, selected credit reviews, credit scoring to compare lenders' performance, and industry concentration analysis. The oversight program is also developing on-site safety and soundness examinations and off-site monitoring of Small Business Lending Companies and compliance reviews of SBA lenders.

To operate more efficiently, SBA has implemented an automated loan origination system for the Disaster Loan program. The system eliminates the paper intensive processes that had been used for decades by the Office of Disaster Assistance. Savings are projected at approximately $5 million per year under the new system. SBA is also transforming the way that staff perform loan management functions in both the 7(a) and 504 programs. In 2004, SBA implemented new procedures for Section 504 loan processing. Results have been positive with the average loan processing time reduced from four weeks to only a few days. In 2005, SBA streamlined its 7(a) guarantee processing function. Similarly, SBA has also centralized its loan liquidation functions for guaranteed programs resulting in a 78 percent reduction in related administrative costs. These efforts have allowed the agency to reduce staffing levels while improving customer service.

The 2007 Budget proposes to continue providing preferential loan terms to victims of disasters. However, in order to contain the escalating costs of the loans while matching borrowers' assistance needs, the Budget proposes to adopt graduated interest rates for the Disaster Loan program. During the first five years after a disaster, interest rates will remain deeply subsidized, as they are currently structured, although interest rate caps would be eliminated. Thereafter, rates would graduate to those of comparable-maturity Treasury instruments. This structure would continue to provide borrowers with deep interest subsidies when they need them most—immediately after a disaster—and after five years the subsidies would be reduced for the remainder of the loan period.

In addition, the 2007 Budget builds upon the success of eliminating credit subsidy requirements for the 7(a) loan program by proposing that borrowers cover the costs of administering Federal guarantees on business loans greater than $1 million. This will make these loans self-financing and reduce the need for taxpayer support by about $7 million.

USDA Rural Infrastructure and Business Development Programs

USDA provides grants, loans, and loan guarantees to communities for constructing facilities such as health-care clinics, day-care centers, and water systems. Direct loans are available at lower interest rates for the poorest communities. These programs have very low default rates. The cost associated with them is due primarily to subsidized interest rates that are below the prevailing Treasury rates.

The program level for the Water and Wastewater (W&W) treatment facility loan and grant program in the 2007 President's Budget is $1.4 billion. These funds are available to communities of 10,000 or fewer residents. Applicant communities must be unable to finance their needs through their own resources or with commercial credit. Priority is given based on their median household income, poverty levels, and size of service population as determined by USDA. Communities typically receive a grant/loan combination. The grant may be up to 75 percent of project costs; however, many projects are viable with 70 percent or more of the projects costs financed with a loan. The 2007 Budget reflects a significant change in the method for determining the interest rate charged on such loans, from a three-tiered structure (poverty, intermediate, and market) depending on community income to an interest rate that is 60 percent of the market rate not to exceed 5 percent. This change is expected to substantially reduce the loan repayment costs for most communities, at a lower loan to grant ratio. The community facility program is targeted to rural communities with fewer than 20,000 residents. It will have a program level of $522 million in 2007.

USDA also provides grants, direct loans, and loan guarantees to assist rural businesses, including cooperatives, and to increase employment and diversify the rural economy. In 2006, USDA proposes to provide almost $1 billion in loan guarantees to rural businesses that serve communities of 50,000 or less. USDA also provides rural business loans through the Intermediary Relending Program (IRP), which provides loan funds at a 1 percent interest rate to an intermediary, such as a State or local government agency that, in turn, provides funds for economic and community development projects in rural areas. Overall, USDA expects to retain or create over 73,000 jobs through its business programs in 2007, primarily through the Business and Industry guarantee and the IRP loan programs.

Electric and Telecommunications Loans

USDA's Rural Utilities Service (RUS) programs provide loans for rural electrification, telecommunications, distance learning, telemedicine, and broadband, and also provide grants for distance learning and telemedicine (DLT).

The Budget includes $3.8 billion in direct electric loans, $690 million in direct telecommunications loans, $356 million in broadband loans and $25 million in DLT grants. The budget proposes blocking the mandatory broadband funding and providing discretionary funding. The demand for loans to rural electric cooperatives has been increasing and is expected to increase further as borrowers replace many of the 40-year-old electric plants.

The Rural Telephone Bank is in the process of dissolving. All stock will be redeemed during 2006 and no new loans will be provided. Loans approved in prior years, but not disbursed will still be available for borrowers at modified terms to reflect the bank's dissolution.

Loans to Farmers

The Farm Service Agency (FSA) assists low-income family farmers in starting and maintaining viable farming operations. Emphasis is placed on aiding beginning and socially disadvantaged farmers. FSA offers operating loans and ownership loans, both of which may be either direct or guaranteed loans. Operating loans provide credit to farmers and ranchers for annual production expenses and purchases of livestock, machinery, and equipment. Farm ownership loans assist producers in acquiring and developing their farming or ranching operations. As a condition of eligibility for direct loans, borrowers must be unable to obtain private credit at reasonable rates and terms. As FSA is the "lender of last resort," default rates on FSA direct loans are generally higher than those on private-sector loans. However, in recent years the loss rate has decreased to 3.1 percent in 2005, compared to 3.4 percent in 2004. FSA-guaranteed farm loans are made to more creditworthy borrowers who have access to private credit markets. Because the private loan originators must retain 10 percent of the risk, they exercise care in examining the repayment ability of borrowers. As a result, losses on guaranteed farm loans remain low with default rates of 0.45 percent in 2005, as compared to 0.69 percent in 2004. The subsidy rates for these programs have been fluctuating over the past several years. These fluctuations are mainly due to the interest component of the subsidy rate.

In 2005, FSA provided loans and loan guarantees to approximately 26,000 family farmers totaling $3 billion. The number of loans provided by these programs has fluctuated over the past several years. The average size for farm ownership loans has been increasing. The majority of assistance provided in the operating loan program is to existing FSA farm borrowers. In the farm ownership program, new customers receive the bulk of the benefits furnished. The demand for FSA direct and guaranteed loans continues to be high due to low crop/livestock prices and some regional production problems. In 2007, FSA proposes to make $3.4 billion in direct and guaranteed loans through discretionary programs. In addition, FSA proposes to increase fees on many of its guaranteed loan programs to reduce the cost of the program and bring the fees in line with other Federal guaranteed loan programs.

To improve program effectiveness further, FSA conducted in 2005 an in-depth review of its direct loan portfolios to assess program performance, including the effectiveness of targeted assistance and the ability of borrowers to graduate to private credit. The results of this review will assist FSA in improving the delivery of its services and the economic viability of farmers and ranchers. Contingent on availability of adequate resources in 2006, FSA will conduct a similar study of its guaranteed loan program.

The Farm Credit System and Farmer Mac

The Farm Credit System (FCS or System) and the Federal Agricultural Mortgage Corporation (FarmerMac) are Government-Sponsored Enterprises (GSEs) that enhance credit availability for the agricultural sector. The FCS provides production, equipment, and mortgage lending to farmers and ranchers, aquatic producers, their cooperatives, related businesses, and rural homeowners, while Farmer Mac provides a secondary market for agricultural real estate and rural housing mortgages.

The Farm Credit System

The financial condition of the System's banks and associations has continued to improve. The ratio of capital to assets increased to 17.1 percent at year-end 2004 from an already high level of 16.1 percent at year-end 2001. As of September 30, capital consisted of $2 billion in restricted capital held by the Farm Credit System Insurance Corporation (FCSIC) and $20.7 billion of unrestricted capital—a record level. Nonperforming loans decreased, and earnings increased, although rising short-term interest rates moderately squeezed interest margins. The examinations by the Farm Credit Administration (FCA), the FAC's Federal regulator, also show the strong financial condition of FCS institutions. As of September 2005, all FCA institutions had one of the top two examination ratings (1 or 2 in a 1–5 scale). Assets grew at a brisk pace (over 7 percent annual rate) in recent years, while the number of FCS institutions decreased due to consolidation. In September 2002, there were seven banks and 104 associations; by September 2005, there were five banks and 96 associations.

The FCSIC ensures the timely payment of principal and interest on FCS obligations. FCSIC manages the Insurance Fund which supplements the System's capital and the joint and several liability of the System banks. On September 30, 2005, the assets in the Insurance Fund totaled $2.029 billion. Of that amount, $40 million was allocated to the Allocated Insurance Reserve Accounts (AIRAs). On September 20, 2005, the Insurance Fund as a percentage of adjusted insured debt was 1.87 percent in the unallocated Insurance Fund and 1.91 percent including the AIRAs. This was below the Secure Base target of 2 percent. During 2005, growth in System debt has outpaced the capitalization of the Insurance Fund that occurs through investment earnings and the accrual of premiums. In addition, the Insurance Fund paid out $231 million toward the retirement of the remaining Financial Assistance Corporation (FAC) bonds. On June 10, 2005, the FAC repaid its remaining debt obligations of $325 million and also repaid all interest advanced by the U.S. Treasury ($440 million).

Over the past 12 months, the System's loans outstanding have grown by $8.3 billion, or 8.8 percent, while over the past three years they have grown $15.3 billion, or 17.4 percent. As required by law, all borrowers are also stockholder owners of System banks and associations. As of September 30, 2005, the System has more than 461,000 stockholders. Loans to young, beginning, and small farmers and ranchers represented 12.7, 19.1, and 31.0 percent, respectively, of the total dollar volume of farm loans outstanding at the end of 2004. The percentage of loans to beginning farmers increased in 2004, while loans to young and small farmers were slightly lower. Young, beginning, and small farmers are not mutually exclusive groups, and thus, cannot be added across categories. Providing credit and related services to young, beginning, and small farmers and ranchers is a legislated mandate and a high priority for the System.

The System, while continuing to record strong earnings and capital growth, remains exposed to a variety of risks associated with the agricultural sector, including concentration risk, changes in real estate values, weather-related catastrophes, possible changes to government programs, volatile commodity prices, animal and plant diseases, and uncertain prospects of off-farm employment.

Farmer Mac

Farmer Mac was established in 1987 to facilitate a secondary market for farm real estate and rural housing loans. The Farm Credit System Reform Act of 1996 transformed Farmer Mac from a guarantor of securities backed by loan pools into a direct purchaser of mortgages, enabling it to form pools to securitize. This change increased Farmer Mac's ability to provide liquidity to agricultural mortgage lenders. Since then, Farmer Mac's program activities and business have increased significantly.

Farmer Mac continues to meet core capital and regulatory risk-based capital requirements. Farmer Mac's total program activity (loans purchased and guaranteed, AgVantage bond assets, and real estate owned) as of September 30, 2005, totaled $5.1 billion. That volume represents a decrease of 7.5 percent from program activity at September 30, 2004. Farmer Mac attributes the decline to ample liquidity among rural lenders and the generally strong financial position of farmers currently. Of total program activity, $2.1 billion were on-balance sheet loans and agricultural mortgage-backed securities, and $3.0 billion were off-balance sheet obligations. Total assets were $4.3 billion at the close of the third quarter, with nonprogram investments accounting for $2.0 billion of those assets. Farmer Mac's net income for first three quarters of 2005 was $22.4 million, an increase of $2.4 million or 11.6 percent over the same period in 2004.

International Credit Programs

Seven Federal agencies—the Department of Agriculture (USDA), the Department of Defense, the Department of State, the Department of the Treasury, the Agency for International Development (USAID), the Export-Import Bank, and the Overseas Private Investment Corporation (OPIC)—provide direct loans, loan guarantees, and insurance to a variety of foreign private and sovereign borrowers. These programs are intended to level the playing field for U.S. exporters, deliver robust support for U.S. manufactured goods, stabilize international financial markets, and promote sustainable development.

Leveling the Playing Field

Federal export credit programs counter subsidies that foreign governments, largely in Europe and Japan, provide their exporters, usually through export credit agencies (ECAs). The U.S. Government has worked since the 1970's to constrain official credit support through a multilateral agreement in the Organization for Economic Cooperation and Development (OECD). This agreement has significantly constrained direct interest rate subsidies and tied-aid grants. Further negotiations resulted in a multilateral agreement that standardized the fees for sovereign lending across all ECAs beginning in April 1999. Fees for non-sovereign lending, however, continue to vary widely across ECAs and markets, thereby providing implicit subsidies.

The Export-Import Bank attempts to "level the playing field" strategically and to fill gaps in the availability of private export credit. The Export-Import Bank provides export credits, in the form of direct loans or loan guarantees, to U.S. exporters who meet basic eligibility criteria and who request the Bank's assistance. USDA's "GSM" programs similarly help to level the playing field. Like programs of other agricultural exporting nations, GSM programs guarantee payment from countries and entities that want to import U.S. agricultural products but cannot easily obtain credit. The U.S. has been negotiating in the OECD the terms of agricultural export financing, the outcome of which could affect the GSM programs.

Stabilizing International Financial Markets

In today's global economy, the health and prosperity of the American economy depend importantly on the stability of the global financial system and the economic health of our major trading partners. The United States can contribute to orderly exchange arrangements and a stable system of exchange rates by providing resources on a multilateral basis through the IMF (discussed in other sections of the Budget), and through financial support provided by the Exchange Stabilization Fund (ESF).

The ESF may provide "bridge loans" to other countries in times of short-term liquidity problems and financial crises. A loan or credit may not be made for more than 6 months in any 12-month period unless the President gives Congress a written statement that unique or emergency circumstances require the loan or credit be for more than 6 months.

Using Credit to Promote Sustainable Development

Credit is an important tool in U.S. bilateral assistance to promote sustainable development. USAID's Development Credit Authority (DCA) allows USAID to use a variety of credit tools to support its development activities abroad. This unit encompasses newer DCA activities, such as municipal bond guarantees for local governments in developing countries, as well as USAID's traditional microenterprise and urban environmental credit programs. DCA provides non-sovereign loans and loan guarantees in targeted cases where credit serves more effectively than traditional grant mechanisms to achieve sustainable development. DCA is intended to mobilize host country private capital to finance sustainable development in line with USAID's strategic objectives. Through the use of partial loan guarantees and risk sharing with the private sector, DCA stimulates private-sector lending for financially viable development projects, thereby leveraging host-country capital and strengthening sub-national capital markets in the developing world. While there is clear demand for DCA's facilities in some emerging economies, the utilization rate for these facilities is still very low.

OPIC also supports a mix of development, employment, and export goals by promoting U.S. direct investment in developing countries. OPIC pursues these goals through political risk insurance, direct loans, and guarantee products, which provide finance, as well as associated skills and technology transfers. These programs are intended to create more efficient financial markets, eventually encouraging the private sector to supplant

OPIC finance in developing countries. OPIC has also created a number of investment funds that provide equity to local companies with strong development potential.

Ongoing Coordination

International credit programs are coordinated through two groups to ensure consistency in policy design and credit implementation. The Trade Promotion Coordinating Committee (TPCC) works within the Administration to develop a National Export Strategy to make the delivery of trade promotion support more effective and convenient for U.S. exporters.

The Interagency Country Risk Assessment System (ICRAS) standardizes the way in which agencies budget for the cost associated with the risk of international lending. The cost of lending by the agencies is governed by proprietary U.S. Government ratings, which correspond to a set of default estimates over a given maturity. The methodology establishes assumptions about default risks in international lending using averages of international sovereign bond market data. The strength of this method is its link to the market and an annual update that adjusts the default estimates to reflect the most recent risks observed in the market.

For 2007, OMB updated the default estimates using the default estimate methodology introduced in FY 2003 and the most recent market data. The 2003 default estimate methodology implemented a significant revision that uses more sophisticated financial analyses and comprehensive market data, and better isolates the expected cost of default implicit in interest rates charged by private investors to sovereign borrowers. All else being equal, this change expands the level of international lending an agency can support with a given appropriation. For example, the Export-Import Bank will be able to provide generally higher lending levels using lower appropriations in 2007.

Adapting to Changing Market Conditions

Overall, officially supported finance and transfers account for a tiny fraction of international capital flows. Furthermore, the private sector is continuously adapting its size and role in emerging markets finance to changing market conditions. In response, the Administration is working to adapt international lending at Export-Import Bank and OPIC to dynamic private sector finance. The Export-Import Bank, for example, is developing a sharper focus on lending that would otherwise not occur without Federal assistance. Measures under development include reducing risks, collecting fees from program users, and improving the focus on exporters who truly cannot access private export finance.

OPIC in the past has focused relatively narrowly on providing financing and insurance services to large U.S. companies investing abroad. As a result, OPIC did not devote significant resources to its mission of promoting development through mobilizing private capital. In 2003, OPIC implemented new development performance measures and goals that reflect the mandate to revitalize its core development mission.

These changes at the Export-Import Bank and at OPIC will place more emphasis on correcting market imperfections as the private sector's ability to bear emerging market risks becomes larger, more sophisticated, and more efficient.

IV. INSURANCE PROGRAMS

Deposit Insurance

Federal deposit insurance promotes stability in the U.S. financial system. Prior to the establishment of Federal deposit insurance, failures of some depository institutions often caused depositors to lose confidence in the banking system and rush to withdraw deposits. Such sudden withdrawals caused serious disruption to the economy. In 1933, in the midst of the Depression, the system of Federal deposit insurance was established to protect small depositors and prevent bank failures from causing widespread disruption in financial markets. The Federal deposit insurance system came under serious strain in the late 1980s and early 1990s when over 2,500 banks and thrifts failed. The Federal Government responded with a series of reforms designed to improve the safety and soundness of the banking system. These reforms, combined with more favorable economic conditions, helped to restore the health of depository institutions and the deposit insurance system.

While the deposit insurance system for banks and thrifts today is generally sound and well managed, inherent weaknesses in the system prompted the President to propose reforms, including the establishment of a new combined, stronger Federal Deposit Insurance Corporation (FDIC) insurance fund and increased flexibilities for the FDIC regarding fund levels and the authority to charge premiums. These new authorities would allow the FDIC to better manage the fund and help avoid strain on financial institutions by stabilizing industry costs over time instead of having a potential for sharp premium increases when the economy may be under stress. Many of these reforms, including the merger of the insurance funds, were included in the Deficit Reduction Act of 2005, which the Budget assumes will be enacted before publication.

The FDIC insures deposits in banks and savings associations (thrifts). The National Credit Union Administration (NCUA) insures deposits (shares) in most credit unions (certain credit unions are privately insured). FDIC and NCUA insure deposits up to $100,000 per account. Under the Deficit Reduction Act of 2005, the deposit insurance ceiling will be changed for various accounts, including an increase for retirement accounts of up to $250,000. Beginning in 2010, and every five years thereafter, FDIC and NCUA will have the authority to increase deposit insurance coverage limits for non-retirement accounts based on inflation if the Boards determine prudent. As of September 30, 2005, FDIC insured $3.8 trillion of deposits at 8,867 commercial banks and thrifts and NCUA insured $515 billion of deposits (shares) at 8,795 credit unions.

Current Industry and Insurance Fund Conditions

For the quarter ending September 30, 2005, insured banks and thrifts continued to report record-high earnings, outpacing the previous quarter's net earnings by $1.4 billion. In the year ending September 30, 2005, industry net income totaled $134 billion—a nine percent increase over the $123 billion income reported for the previous year. Despite the improving trends, some risks remain. Rising interest rates, for example, might cause stresses in certain real-estate markets and strains on banks in those regions.

In 2005, no banks or thrifts failed. In comparison, during the previous year, five banks and thrifts, with combined assets of $175 million dollars, failed. As of September 30, 2005, the FDIC classified 68 institutions with $21 billion in assets as "problem institutions," compared to 95 institutions with $25 billion in assets one year earlier.

Under the Deficit Reduction Act, the FDIC's Bank Insurance Fund (BIF) and its Savings Association Insurance Fund (SAIF) will be merged into the near Deposit Insurance Fund (DIF). At the end of September 2005, the SAIF reserve ratio (ratio of insurance reserves to insured deposits) stood at 1.30 percent—well above the statutory target of 1.25 percent. However, a surge in insured deposits reduced the reserve ratio of BIF to 1.25 percent as of September 2005, when the latest statistics are available. While this just meets the statutory target, it raises the likelihood that all BIF-insured institutions could be assessed premiums in 2006 because of the requirement to maintain the reserve ratio at the statutory target. Under the Deficit Reduction Act, the FDIC will have more flexibility as to when it can charge premiums. Under the Act, the FDIC is authorized to charge risk-based premiums on any member institution to manage fund reserves and can set the reserve ratio at the beginning of each year within a range between 1.15 and 1.50 percent of estimated insured deposits. When an insurance fund is expected to remain above the statutory target, the FDIC is authorized to charge deposit insurance premiums only on institutions that are not well capitalized or well managed, with a maximum premium of 27 cents per $100 of assessable deposits for the riskiest institutions. Due to the strong financial condition of the industry, less than 10 percent of banks and thrifts paid insurance premiums in 2004.

During 2005, 13 Federally-insured credit unions with $148 million in assets failed (including assisted mergers). In comparison, during 2004, 22 Federally-insured credit unions with $120 million in assets failed. The National Credit Union Share Insurance Fund (NCUSIF) ended fiscal year 2005 with assets of $6.3 billion and an equity ratio of 1.27 percent, below the NCUA-set target ratio of 1.30 percent. Each insured credit union is required to deposit and maintain an amount in the NCUSIF equal to one percent of its member share accounts in the fund. The insurance premium charge was waived again during 2005 because the ratio stayed above 1.25 percent. NCUA is required to assess a premium if the ratio falls below 1.20 percent and is authorized to do so if the ratio falls below 1.25 percent.

The Federal banking regulators (the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision) continue to work on a rulemaking that would implement the "International Convergence of Capital Measurement and Capital Standards: A Revised Framework" (Basel II). The original Basel Capital Accord (Basel I) is an international agreement establishing a uniform capital standard across nations. It adopted a risk-based capital requirement that applies a few risk weights to broad categories of assets. The Federal banking regulators issued capital rules based on Basel I in 1989. Basel II would improve the risk-based capital requirement in several ways, including refining risk categories. U.S. regulators are considering requiring the largest banks that have complex financial structures and expertise to use an internal ratings-based approach to calculate credit risk capital requirements, and an advanced measurement approach to calculate operational risk capital requirements. The rule, if adopted, would apply to banks that hold the overwhelming majority of U.S. banking assets. The regulators are using Quantitative Impact Study 4 data recently obtained from banks likely to be covered by the rule to help develop the rulemaking, including the implementation schedule and transition provisions.

Pension Guarantees

The Pension Benefit Guaranty Corporation (PBGC) insures most defined-benefit pension plans sponsored by private employers. PBGC pays the benefits guaranteed by law when a company with an underfunded pension plan meets the legal criteria to transfer its obligations to the pension insurance program. PBGC's claims exposure is the amount by which qualified benefits exceed assets in insured plans. In the near term, the risk of loss stems from financially distressed firms with underfunded plans. In the longer term, loss exposure results from the possibility that currently healthy firms become distressed and currently well-funded plans become underfunded due to inadequate contributions, poor investment results, or increased liabilities.

Losses to the PBGC and benefit losses to workers and retirees are exacerbated by structural flaws in the statutory plan funding requirements and in the design of the insurance program. The pension system is replete with moral hazards that allow the buildup of unfunded pension promises even in plans with weak sponsors, where the risk of plan termination is high. At the same time, PBGC lacks the standard insurance industry safeguards against moral hazards—such as underwriting standards and risk-based premiums.

PBGC monitors troubled companies with underfunded plans and acts to protect the interests of the pension insurance program's stakeholders where possible. Such protections include initiating termination of an underfunded plan in appropriate circumstances. Under its Early Warning Program, PBGC works with companies to strengthen plan funding or otherwise protect the insurance program against avoidable losses. However, PBGC's authority to prevent undue risks to the insurance program is limited.

The combination of the flawed design of the pension insurance system and adverse economic conditions has resulted in PBGC's single-employer program incurring substantial losses from underfunded plan terminations in 2001 through 2005. The table below shows the ten largest plan termination losses to date. As a result of these losses, the program's deficit at 2005 year-end stood at $22.8 billion,[1] compared to a $9.7 billion surplus at 2000 year-end.

LARGEST 10 CLAIMS AGAINST THE PBGC'S SINGLE-EMPLOYER PROGRAM, 1975–2005

Top 10 Firms	Fiscal Years of Plan Terminations	Claims (by firm)	Percent of Total Claims (1975–2005)
1. United Airlines	2005	$7,093,803,951	22.7%
2. Bethlehem Steel	2003	3,654,380,116	11.5%
3. US Airways	2003, 2005	2,861,901,511	9.0%
4. LTV Steel*	2002, 2003, 2004	1,959,679,993	6.2%
5. National Steel	2003	1,161,019,567	3.7%
6. Pan American Air	1991, 1992	841,082,434	2.7%
7. Weirton Steel	2004	690,181,783	2.2%
8. Trans World Airlines	2001	668,377,105	2.1%
9. Kemper Insurance	2005	566,128,387	1.8%
10. Kaiser Aluminum	2004	565,812,015	1.8%
Top 10 Total	....	20,062,366,861	63.3%
All Other Total	....	11,646,148,178	36.7%
TOTAL	....	**$31,708,515,039**	**100.0%**

Sources: PBGC Fiscal Year Closing File (9/30/05), PBGC Case Administration System and PBGC Participant System (PRISM).

Due to rounding, percentages may not add up to 100 percent.

Data in this table have been calculated on a firm basis and include all plans of each firm.

Values and distributions are subject to change as PBGC completes its reviews and establishes termination dates.

* Does not include 1986 termination of a Republic Steel plan sponsored by LTV.

Additional risk exposure remains for the future because of economic uncertainties and significant underfunding in single-employer pension plans, which, on a termination basis, exceeded $450 billion at the end of 2005, the same as a year earlier but now concentrated among larger plans. This exposure is higher than the $350 billion at the end of 2003 and $50 billion at the end of December 2000. PBGC's exposure to "reasonably possible" terminations, the amount of unfunded vested benefits in pension plans sponsored by companies at greater risk of default, was $108 billion at September 30, 2005. The comparable estimates for 2004 and 2003 were $96 billion and $82 billion, respectively. Several large companies in the airline and automotive industries recently filed for bankruptcy with a potential exposure to PBGC in the billions of dollars.

The smaller multiemployer program guarantees pension benefits of certain unionized plans offered by several employers in an industry. It ended 2003 with its first deficit in over 20 years, of about $261 million. The deficit stood at $335 million at the end of 2005, up from $236 million in 2004. Estimated underfunding in multiemployer plans approximated over $200 billion at year-end, up from over $150 billion and $100 billion in 2004 and 2003, respectively.

The agency has sufficient liquidity to meet its obligations for a number of years; however, neither the single-employer nor multiemployer program has the resources to satisfy fully the agency's long-term obligations to plan participants. As of September 30, 2005, the PBGC's single-employer and multiemployer programs together had assets of $57.6 billion to cover liabilities of $80.7 billion, a shortfall of $23.1 billion.

In February 2005 the Administration proposed comprehensive reforms to strengthen funding for workers' defined-benefit pensions; provide more accurate infor-

[1] The 2005 year-end single-employer program deficit of $22.8 billion was less than the $23.3 billion deficit at the end of 2004 because increased losses from new claims were offset by new premiums, favorable liability revaluations due to increasing interest rates, and investment returns. There is no assurance that these results will continue.

mation about pension liabilities and plan underfunding; and enable PBGC to meet its obligations to participants in terminated pension plans. The reforms would:

- Require employers to fully fund their plans by making up their funding shortfall over a reasonable period of time and give companies added flexibility to contribute more in good economic times.
- Require that funding be based on a more accurate measure of liabilities and establish appropriate funding targets based on a plan's risk of termination.
- Update the variable-rate premium to reflect the new funding targets and provide for the PBGC Board to re-examine it periodically to cover the cost of expected claims and to improve PBGC's financial position; and adjust the flat-rate premium to reflect the growth in worker wages.
- Require employers to forgo benefit increases if the sponsor is financially weak or has a significantly underfunded pension plan.
- Require plans to provide timely information on the true financial health of pension plans to workers and make such information publicly available to other stakeholders.

In late December 2005, the Senate approved a conference report on budget reconciliation that contains a premium increase for both the single-employer and multiemployer insurance programs; House action on the conference report is expected early in 2006. In addition, comprehensive pension bills (S. 1783 passed by the Senate on November 16, 2005, and H.R. 2830 passed by the House on December 15, 2005) are expected to be considered by a Conference Committee early in 2006. The Administration is evaluating the bills in light of its pension reform goals and is committed to pension reform that would strengthen funding requirements and restore PBGC to solvency.

Disaster Insurance

Flood Insurance

The Federal Government provides flood insurance through the National Flood Insurance Program (NFIP), which is administered by the Federal Emergency Management Agency of the Department of Homeland Security (DHS). Flood insurance is available to homeowners and businesses in communities that have adopted and enforced appropriate flood plain management measures. Coverage is limited to buildings and their contents. In January 2006, the program had 4.7 million policies in more than 20,100 communities with $811 billion of insurance in force.

Prior to the creation of the program in 1968, many factors made it cost prohibitive for private insurance companies alone to make affordable flood insurance available. In response, the NFIP was established to make affordable insurance coverage widely available. The NFIP requires building standards and other mitigation efforts to reduce losses, and operates a flood hazard mapping program to quantify the geographic risk of flooding. These efforts have made substantial progress.

DHS is using three strategies to increase the number of flood insurance policies in force: lender compliance, program simplification, and expanded marketing. DHS is educating financial regulators about the mandatory flood insurance requirement for properties that are located in floodplains and have mortgages from federally regulated lenders. These strategies have resulted in policy growth of 5 percent in the last 12 months.

DHS also has a multi-pronged strategy for reducing future flood damage. The NFIP offers flood mitigation assistance grants to assist flood victims to rebuild to current building codes including base flood elevations, thereby reducing future flood damage costs. In addition, two newly enacted grant programs will help reduce the number of repetitive loss properties through acquisition, relocation, or elevation, not only helping owners of high-risk property, but reducing a disproportionate drain on the National Flood Insurance Fund. As the new repetitive loss grants are implemented, FEMA will work to ensure that all of the flood mitigation grant programs are closely integrated, resulting in better coordination and communication with State and local governments. Further, through the Community Rating System, DHS adjusts premium rates to encourage community and State mitigation activities beyond those required by the NFIP. These efforts, in addition to the minimum NFIP requirements for floodplain management, save the country well over $1 billion annually in avoided flood damages.

The program's reserve account, which is a cash fund, has sometimes had expenses greater than its revenue. The program's goal of providing affordable insurance does not permit the accumulation of large cash reserves. Currently, structures built prior to flood mapping and NFIP floodplain management requirements pay less than fully actuarial rates. These structures make up less than 25 percent of the total 4.7 million policies in force.

Mostly because of the four major hurricanes in 2004, the NFIP handled 74,000 claims nationwide, resulting in payments totaling more than $2 billon, the highest loss year since the program began in 1968. All but $300 million of these payments were made with the reserve in the fund. However, this record loss year was surpassed in 2005 by a factor of more than 10 because of hurricanes Katrina, Rita, and Wilma. These three storms are expected to result in over 200,000 claims with an estimated payment totaling more than $23 billion. As a result, the Administration and Congress have worked to increase the borrowing authority to make certain that all claims could be paid.

The Administration is also working with Congress to improve the NFIP based on the following principles: protecting the NFIP's integrity by covering existing commitments; phasing out subsidized premiums in order to charge fair and actuarially sound premiums; increasing program participation incentives and improving enforcement of mandatory participation in the program; increasing risk awareness by educating property owners; and reducing future risks by implementing and enhancing mitigation measures. The catastrophic nature of the 2005 hurricane season has also triggered an examination of the program, and the Administration is working with Congress to reform the program to further mitigate the impact of flood damages and losses.

Crop Insurance

Subsidized Federal crop insurance administered by USDA's Risk Management Agency (RMA) assists farmers in managing yield and revenue shortfalls due to bad weather or other natural disasters. RMA continues to evaluate and provide new products so that the Government can further reduce the need for ad-hoc disaster assistance payments to the agriculture community in bad years.

The USDA crop insurance program is a cooperative effort between the Federal Government and the private insurance industry. Private insurance companies sell and service crop insurance policies. These companies rely on reinsurance provided by the Federal Government and also by the commercial reinsurance market to manage their individual risk portfolio. The Federal Government reimburses private companies for the administrative expenses associated with providing crop insurance and reinsures the private companies for excess insurance losses on all policies. The Federal Government also subsidizes premiums for farmers. The Agricultural Risk Protection Act of 2000 (ARPA) increased premium subsidy levels to encourage farmers to purchase higher and more effective levels of coverage.

The 2007 Budget includes a legislative proposal that would require any farmer that receives a Federal commodity payment for his/her crop to buy crop insurance at a minimum coverage level of 50/100. This proposal is intended to ensure farmers have adequate protection in the event of a natural disaster without resorting to ad hoc disaster assistance. Additionally, the Administration's proposal will lower the imputed premium on Catastrophic Crop Insurance (CAT) by 25 percent and charge an administrative fee on CAT equal to the greater of $100 or 25 percent of the (restated) imputed CAT premium, subject to a maximum fee of $5,000. The proposal will also reduce premium subsidies by 5 percentage points on policies with a coverage level of 70 percent or below (75 percent for Group Risk Protection (GRP)) and by 2 percentage points on policies with a coverage level of 75 percent or above (80 percent for GRP). In addition, the proposal reduces the Administrative and Operating reimbursement on all buy-up coverage by 2 percentage points and increases the net book quota share to 22 percent, but provides a ceding commission to the companies of 2 percent. These changes are expected to be in effect in 2008 and will save $140 million a year. This proposal was also included in the 2006 Budget.

In addition, the 2007 Budget includes a proposal to implement a participation fee in the Federal crop insurance program. The proposed participation fee would initially be used to fund modernization of the existing information technology (IT) system and would supplement the annual appropriation provided by Congress. Subsequently, the fee would be shifted to maintenance and would be expected to reduce the annual appropriation. The participation fee would be charged to insurance companies participating in the Federal crop insurance program; based on a rate of about one-half cent per dollar of premium sold, the fee is expected to be sufficient to generate about $15 million annually beginning in 2008. The existing IT system is nearing the end of its useful life and recent years have seen increases in "down-time" resulting from system failures. Over the years, numerous changes have occurred in the Federal crop insurance program; including, the development of revenue and livestock insurance which have greatly expanded the program and taxed the IT system due to new requirements, such as daily pricing, which were not envisioned when the existing IT system was designed. These new requirements contribute to increased maintenance costs and limit RMA's ability to comply with Congressional mandates pertaining to data reconciliation with the Farm Service Agency. The participation fee will alleviate these problems.

There are various types of insurance programs. The most basic type of coverage is CAT, which compensates the farmer for losses in excess of 50 percent of the individual's average yield at 55 percent of the expected market price. The CAT premium is entirely subsidized, and farmers pay only an administrative fee. Additional coverage is available to producers who wish to insure crops above the CAT coverage level. Premium rates for additional coverage depend on the level of coverage selected and vary from crop to crop and county to county. The additional levels of insurance coverage are more attractive to farmers due to availability of optional units, other policy provisions not available with CAT coverage, and the ability to obtain a level of protection that permits them to use crop insurance as loan collateral and to achieve greater financial security. For the ten principal crops, which account for about 80 percent of total liability, over 75 percent of eligible acres participated in the crop insurance program.

For producers purchasing the additional levels of insurance, there are a wide range of yield and revenue-based insurance products available through the Federal crop insurance program. Revenue insurance programs protect against loss of revenue stemming from low prices, poor yields, or a combination of both. These programs extend traditional multi-peril crop insurance protection by adding price variability to production history. Indemnities are due when any combination of yield and price results in revenue that is less than the revenue guarantee. The price component common to these plans uses the commodity futures market for price discovery. Revenue products have gained wide acceptance among producers and have played an integral role in providing more effective risk management options for the Nation's agricultural producers. In crop year 2005, revenue products accounted for about 54 percent of policies earning premium, 52 percent of net insured acres, and 62 percent of total program liability.

USDA also continues to expand coverage. In 2005, a sugar beet stage removal pilot and a Silage Sorghum pilot were introduced. In addition, RMA made Adjusted Gross Revenue-Lite available in five additional States, and expanded Livestock Risk Protection. RMA also submitted two new risk management tools for pasture, rangeland and forage protection for consideration. It is expected in 2006 that the Livestock Gross Margin pilot program will be expanded to include cattle. RMA is also making substantial improvements to the Florida Fruit Tree pilot program to enhance coverage and make it more effective for loss due to hurricane. RMA also expanded the Group Risk Income Protection plans for cotton, wheat and grain sorghum for the 2006 crop year. RMA continues to pursue a number of avenues to increase program participation among underserved States and commodities by working on declining yield issues and looking at discount programs for good experienced producers who pose less risk.

For more information and additional crop insurance program details, please reference RMA's web site: (*www.rma.usda.gov*).

Insurance Against Security-Related Risks

Terrorism Risk Insurance

On November 26, 2002, President Bush signed into law the Terrorism Risk Insurance Act of 2002. The Act was designed to address disruptions in economic activity caused by the withdrawal of many insurance companies from the marketplace for terrorism risk insurance in the aftermath of the terrorist attacks of September 11, 2001. Their withdrawal in the face of great uncertainty as to their risk exposure to future terrorist attacks led to a moratorium on many new construction projects, increasing business costs for the insurance that was available, and substantially shifting risk—from reinsurers to primary insurers, and from insurers to policyholders (e.g., investors, businesses, and property owners). Ultimately, these costs were borne by American workers and communities through decreased development and economic activity.

The Act established a temporary, three-year Federal program that provided a system of shared public and private compensation for insured commercial property and casualty losses arising from acts of terrorism (as defined by the Act). Under the Act, insurance companies included in the program were required to make available to their policyholders coverage for losses from acts of terrorism. In the event of a terrorist attack on private businesses and others covered by this program, the Federal Government would cover 90 percent of the insured losses above each insurance company's deductible (as specified in the Act). The Act also provided authority for the Department of the Treasury to recoup Federal payments via surcharges on policyholders.

The Act required the Department of the Treasury to conduct a study on the effectiveness of the program and to report the results to Congress by June 30, 2005. Treasury found that the Act had achieved its goals of supporting the insurance industry during a transitional period and had stabilized the private insurance market. Extending the Act in its then-current form was likely to hinder further development of the terrorism risk insurance market by crowding out innovation and capacity building. As a result, the Administration sought significant reforms to the program.

In December 2005, Congress extended the program for two years, through December 31, 2007, and the President signed it into law. The 2005 Act continues to require insurance company participants to make available terrorism risk insurance through the fifth and final year. But, the 2005 Act significantly reduces taxpayers' exposure by excluding certain lines of insurance from Federal coverage: Commercial automobile, burglary and theft, surety, professional liability, and farm owners multiple peril are removed from the program altogether. In addition, the 2005 Act increases insurers' deductibles from 15 percent of direct earned premiums for calendar year 2005 to 17.5 percent in 2006 and 20 percent in 2007. The extension also decreases the Federal co-payment for insured losses above the insurers' deductibles from 90 percent of insured losses in calendar year 2005 and 2006 to 85 percent of insured losses in 2007.

Finally, the new legislation increases the trigger amount for Federal payments, currently at $5 million in aggregate insured losses from an act of terrorism. After March 31, 2006, no Treasury payments can be made unless the aggregate industry insured losses exceed $50 million in calendar year 2006 or $100 million in calendar year 2007. Neither the Department of the Treasury nor any insurer will be liable for any amount exceeding the statutory annual cap of $100 billion in aggregate insured losses. Above that amount, the Act states that Congress will determine the procedures that would govern any further payments.

Airline War Risk Insurance

After the September 11, 2001 attacks, private insurers cancelled third-party liability war risk coverage for airlines and dramatically increased the cost of other war risk insurance. In response, the Department of Transportation (DOT) provided a one-time reimbursement to airlines for the increased cost of aviation hull and passenger liability war risk insurance under the authority provided in P.L. 107–42. DOT also offered airlines short duration third-party liability war risk insurance at subsidized rates because coverage was initially withdrawn by private insurers followed by a period of marketplace disruption. Currently, aviation war risk insurance coverage is generally available from private insurers, albeit at significantly higher costs. However, commercial insurance coverage for occurrences involving weapons of mass destruction is now being withdrawn from the market. Because of this program, airlines receive financial protection from war risk occurrences and are able to meet conditions imposed by aircraft liens and leases.

The Homeland Security Act of 2002 (HSA) included airline war risk insurance legislation. The HSA and subsequent authorization and appropriation acts directed the continuation of third party liability war risk insurance policies in effect on June 19, 2002 through August 31, 2006 at the premium rate in effect on June 19, 2002. The Secretary is authorized to limit the third party liability of air carriers and aircraft and aircraft engine manufacturers to $100 million, when the Secretary certifies that the loss is from an act of terrorism. The acts further required the scope of insurance coverage to include war risk hull loss and passenger and crew liability at a total policy premium not to exceed twice that charged for third party liability. Consequently, the President has issued several Presidential Determinations, the most recent on December 22, 2005, authorizing the continued provision of aviation war risk insurance through August 31, 2006 and the DOT has issued policies to conform to HSA requirements.

Currently 75 air carriers are insured by DOT. Coverage for individual carriers ranges from $80 million to $4 billion per carrier with the median insurance coverage at approximately $1.8 billion per occurrence. Premiums collected by the Government are deposited into the Aviation Insurance Revolving Fund. In FY 2005, the fund earned approximately $164 million in premiums for insurance provided by DOT, and it is anticipated that $144 million in premiums will also be earned in FY 2006. No claims have been paid by the program since its expansion in 2001. At the end of 2005, the balance of the Aviation Insurance Revolving Fund available for payment of future claims was $568 million. The balance in the fund is sufficient to pay small claims, but would be inadequate to meet the coverage limits of the largest policies in force ($4 billion) or a series of large claims. The Federal Government would pay any claims by the airlines that exceed the balance in the aviation insurance revolving fund. The Administration does not support a straight extension of this program, which crowds out private sector mechanisms for managing risk. Looking forward, the Administration is committed to working with Congress to ensure that air carriers more equitably share in the risks associated with this program.

Chart 7-3. Face Value of Federal Credit Outstanding

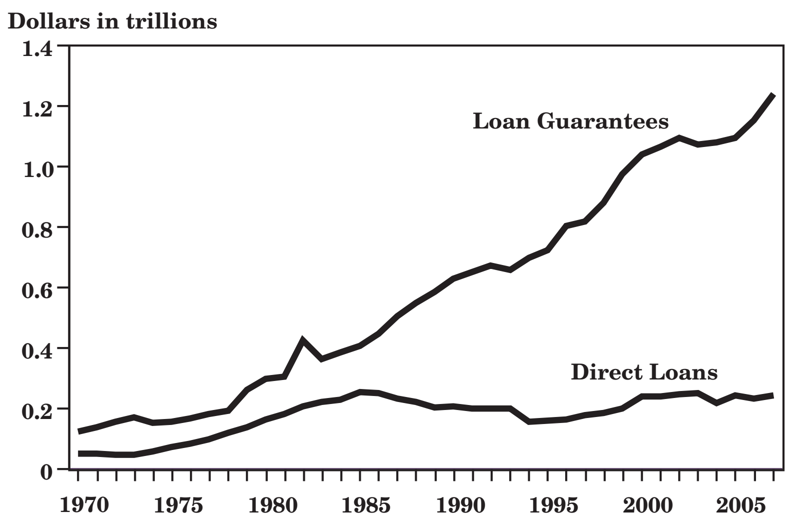


Table 7–1. ESTIMATED FUTURE COST OF OUTSTANDING FEDERAL CREDIT PROGRAMS

(In billions of dollars)

Program	Outstanding 2004	Estimated Future Costs of 2004 Outstanding [1]	Outstanding 2005	Estimated Future Costs of 2005 Outstanding [1]
Direct Loans: [2]				
Federal Student Loans	107	8	113	11
Farm Service Agency (excl. CCC), Rural Development, Rural Housing	43	10	43	9
Rural Utilities Service and Rural Telephone Bank	32	3	34	2
Housing and Urban Development	13	2	12	2
Export-Import Bank	12	5	10	5
Public Law 480	9	5	9	4
Agency for International Development	8	3	8	3
Commodity Credit Corporation	7	3	3	1
Federal Communications Commission	4	4	*	*
Disaster Assistance	3	1	4	1
VA Mortgage	2	*	1	*
Other Direct Loan Programs	13	2	11	3
Total Direct Loans	251	46	247	41
Guaranteed Loans: [2]				
FHA Mutual Mortgage Insurance Fund	384	1	336	2
VA Mortgage	351	4	206	3
Federal Family Education Loan Program	245	23	289	31
FHA General/Special Risk Insurance Fund	91	4	90	3
Small Business	57	2	73	2
Export-Import Bank	36	2	36	2
International Assistance	21	2	22	2
Farm Service Agency (excl. CCC), Rural Development, Rural Housing	29	1	30	1
Commodity Credit Corporation	4	*	2	*
Maritime Administration	3	*	3	*
Air Transportation Stabilization Program	2	1	1	1
Government National Mortgage Association (GNMA) [3]	....	*	....	*
Other Guaranteed Loan Programs	8	3	8	1
Total Guaranteed Loans	1,231	43	1,096	48
Total Federal Credit	**1,482**	**89**	**1,343**	**89**

* $500 million or less.

[1] Direct loan future costs are the financing account allowance for subsidy cost and the liquidating account allowance for estimated uncollectible principal and interest. Loan guarantee future costs are estimated liabilities for loan guarantees.

[2] Excludes loans and guarantees by deposit insurance agencies and programs not included under credit reform, such as CCC commodity price supports. Defaulted guaranteed loans which become loans receivable are accounted for as direct loans.

[3] GNMA data are excluded from the totals because they are secondary guarantees on loans guaranteed by FHA, VA and RHS.

Table 7–2. REESTIMATES OF CREDIT SUBSIDIES ON LOANS DISBURSED BETWEEN 1992–2005 [1]

(Budget authority and outlays, in millions of dollars)

Program	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
DIRECT LOANS:												
Agriculture:												
Agriculture credit insurance fund	28	2	–31	23	....	331	–656	921	10	–701	–147	–2
Farm storage facility loans	....	....	....	....	....	....	....	–1	–7	–8	7	–1
Apple loans	....	....	....	....	....	....	....	–2	1	....	*	*
Emergency boll weevil loan	....	....	....	....	....	....	....	....	1	*	*	3
Agricultural conservation	....	....	....	....	....	....	....	....	....	....	....	....
Distance learning and telemedicine	....	....	....	....	....	....	....	1	–1	–1	1	....
Rural electrification and telecommunications loans	61	–37	84	....	–39	....	–17	–42	101	265	143	....
Rural telephone bank	....	....	10	....	–9	....	–1	....	–3	–7	–6	....
Rural housing insurance fund	152	46	–73	....	71	....	19	–29	–435	–64	–200	....
Rural economic development loans	....	....	1	....	–1	*	....	–1	–1	....	–2	....
Rural development loan program	1	....	....	....	–6	....	....	–1	–3	....	–3	....
Rural community advancement program [2]	....	....	8	....	5	....	37	3	–1	–84	–34	....
P.L. 480	....	–37	–1	....	....	....	–23	65	–348	33	–43	–239
P.L. 480 Title I food for progress credits	84	–38	....	....	....	....	....	....	–112	–44	....	....
Commerce:												
Fisheries finance	....	....	....	....	....	....	–19	–1	–3	....	1	–14
Defense:												
Military housing improvement fund	....	....	....	....	....	....	....	....	....	....	*	–4
Education:												
Federal direct student loan program: [3]												
Volume reestimate	....	....	....	....	22	....	–6	....	43	....	....	....
Other technical reestimate	....	3	–83	172	–383	–2,158	560	....	3,678	1,999	855	2,827
College housing and academic facilities loans	....	....	....	....	....	....	–1	....	....	....	....	....
Homeland Security:												
Disaster assistance	....	....	....	....	....	47	36	–7	–6	*	4	*
Interior:												
Bureau of Reclamation loans	....	....	....	....	....	3	3	–9	–14	....	17	1
Bureau of Indian Affairs direct loans	....	....	....	....	1	5	–1	–1	2	*	*	*
Assistance to American Samoa	....	....	....	....	....	....	....	....	....	*	*	2
State												
Repatriation loans	....	....	....	....	....	....	....	....	....	....	....	–3
Transportation:												
High priority corridor loans	....	....	....	–3	....	....	....	....	....	....	....	....
Alameda corridor loan	....	....	....	....	....	–58	....	....	....	–12	....	....
Transportation infrastructure finance and innovation	....	....	....	....	....	....	18	....	....	....	3	–11
Railroad rehabilitation and improvement program	....	....	....	....	....	....	....	....	....	–5	–14	–11
Treasury:												
Community development financial institutions fund	....	....	....	....	....	1	....	....	*	–1	*	–1
Veterans Affairs:												
Veterans housing benefit program fund	30	76	–72	465	–111	–52	–107	–697	17	–178	987	–47
Native American veteran housing	....	....	....	....	....	....	....	....	–3	*	*	*
Vocational Rehabilitation Loans	....	....	....	....	....	....	....	....	*	*	*	–1
Environmental Protection Agency:												
Abatement, control and compliance	....	....	....	....	....	....	3	–1	*	–3	*	*
International Assistance Programs:												
Foreign military financing	....	....	13	4	1	152	–166	119	–397	–64	–41	–7
U.S. Agency for International Development:												
Micro and small enterprise development	....	....	....	....	....	....	....	*	....	*	....	....
Overseas Private Investment Corporation:												
OPIC direct loans	....	....	....	....	....	....	....	....	–4	–21	3	–7
Debt reduction	....	....	....	....	....	36	–4	....	*	–47	–104	54
Small Business Administration:												
Business loans	....	....	....	....	....	....	1	–2	1	25	....	–16
Disaster loans	....	....	....	–193	246	–398	–282	–14	266	589	196	61
Other Independent Agencies:												
Export-Import Bank direct loans	–16	37	....	....	....	–177	157	117	–640	–305	111	–257
Federal Communications Commission	....	....	....	4,592	980	–1,501	–804	92	346	380	732	–24
LOAN GUARANTEES:												
Agriculture:												
Agriculture credit insurance fund	14	12	–51	96	....	–31	205	40	–36	–33	–22	–162

Table 7–2. REESTIMATES OF CREDIT SUBSIDIES ON LOANS DISBURSED BETWEEN 1992–2005 [1]—Continued

(Budget authority and outlays, in millions of dollars)

Program	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Agriculture resource conservation demonstration	....	....	....	....	....	....	2	....	1	–1	*	*
Commodity Credit Corporation export guarantees	103	–426	343	....	....	....	–1,410	....	–13	–230	–205	–366
Rural development insurance fund	....	....	–3	....	....	....	....	....	....	....	....	....
Rural housing insurance fund	10	7	–10	....	109	....	152	–56	32	50	66	....
Rural community advancement program	....	....	–10	....	41	....	63	17	91	15	29	....
Commerce:												
Fisheries finance	....	....	....	–2	....	....	–3	–1	3	*	1	*
Emergency steel guaranteed loans	....	....	....	....	....	....	....	....	50	*	3	–75
Emergency oil and gas guaranteed loans	....	....	....	....	....	....	*	*	*	*	*	–1
Defense:												
Military housing improvement fund	....	....	....	....	....	....	....	....	....	–3	–1	–3
Defense export loan guarantee	....	....	....	....	....	....	....	....	....	....	–5	....
Education:												
Federal family education loan program: [3]												
Volume reestimate	....	535	99	....	–13	–60	–42	....	277	....	....	....
Other technical reestimate	421	60	....	....	–140	667	–3,484	....	–2,483	–3,278	1,348	6,837
Health and Human Services:												
Heath center loan guarantees	....	....	....	....	....	3	....	*	*	....	1	*
Health education assistance loans	....	....	....	....	....	....	....	....	–5	–37	–33	–18
Housing and Urban Development:												
Indian housing loan guarantee	....	....	....	....	....	....	–6	*	–1	*	–3	–1
Title VI Indian guarantees	....	....	....	....	....	....	....	....	–1	1	4	*
Community development loan guarantees	....	....	....	....	....	....	....	....	....	19	–10	–2
FHA-mutual mortgage insurance	....	....	–340	....	3,789	....	2,413	–1,308	1,100	5,947	1,979	2,842
FHA-general and special risk	....	–110	–25	743	79	....	–217	–403	77	352	507	238
Interior:												
Bureau of Indian Affairs guaranteed loans	....	....	31	....	....	....	–14	–1	–2	–2	*	15
Transportation:												
Maritime guaranteed loans (title XI)	....	....	....	....	–71	30	–15	187	27	–16	4	–76
Minority business resource center	....	....	....	....	....	....	....	1	....	*	*	....
Treasury:												
Air transportation stabilization program	....	....	....	....	....	....	....	....	113	–199	292	–109
Veterans Affairs:												
Veterans housing benefit fund program	167	334	–706	38	492	229	–770	–163	–184	–1,515	–462	–843
International Assistance Programs:												
U.S. Agency for International Development:												
Development credit authority	....	....	....	....	....	....	....	–1	....	1	–3	–2
Micro and small enterprise development	....	....	....	....	....	....	....	....	....	2	–2	–3
Urban and environmental credit	–1	–7	....	–14	....	....	....	–4	–15	48	–2	–5
Assistance to the new independent states of the former Soviet Union	....	....	....	....	....	....	....	–34	....	....	....	....
Loan Guarantees to Israel	....	....	....	....	....	....	....	....	....	–76	–111	188
Loan Guarantees to Egpyt	....	....	....	....	....	....	....	....	....	....	....	7
Overseas Private Investment Corporation:												
OPIC guaranteed loans	....	....	....	....	....	....	....	5	77	60	–212	–21
Small Business Administration:												
Business loans	....	257	–16	–279	–545	–235	–528	–226	304	1,750	1,034	–390
Other Independent Agencies:												
Export-Import Bank guarantees	–59	13	....	....	....	–191	–1,520	–417	–2,042	–1,133	–655	–1,164
Total	995	727	–832	5,642	4,518	–3,641	–6,427	–1,854	–142	3,468	6,008	9,189

* Less than $500,000.
[1] Excludes interest on reestimates. Additional information on credit reform subsidy rates is contained in the Federal Credit Supplement.
[2] Includes rural water and waste disposal, rural community facilities, and rural business and industry programs.
[3] Volume reestimates in mandatory programs represent a change in volume of loans disbursed in the prior years.

Table 7–3. DIRECT LOAN SUBSIDY RATES, BUDGET AUTHORITY, AND LOAN LEVELS, 2005–2007

(In millions of dollars)

Agency and Program	2005 Actual			2006 Enacted			2007 Proposed		
	Subsidy rate [1]	Subsidy budget authority	Loan levels	Subsidy rate [1]	Subsidy budget authority	Loan levels	Subsidy rate [1]	Subsidy budget authority	Loan levels
Agriculture:									
Agricultural credit insurance fund	7.38	69	935	6.42	67	1,052	9.50	95	1,008
Farm storage facility loans	–1.43	–1	72	–0.84	–1	67	0.25	....	74
Rural community advancement program	6.81	113	1,650	6.09	78	1,287	14.28	184	1,287
Rural electrification and telecommunications loans	–0.96	–47	4,837	–0.51	–31	6,028	–0.81	–36	4,528
Rural telephone bank	–1.83	–3	175	....	....	....	....	....	....
Distance learning, telemedicine, and broadband program	2.11	2	114	2.42	29	1,219	2.90	9	327
Rural housing assistance grants	46.76	3	6	46.76	3	6	47.82	....	....
Farm labor	47.06	16	33	44.59	17	38	47.95	20	42
Rural housing insurance fund	14.70	191	1,288	14.46	215	1,515	10.45	136	1,294
Rural development loan fund	46.38	16	34	43.02	15	34	44.07	15	34
Rural economic development loans	18.79	5	25	19.97	5	25	21.84	8	35
Public law 480 title I direct credit and food for progress	57.55	17	30	54.14	16	30	....	....	....
Commerce:									
Fisheries finance	–9.52	–9	91	–2.60	–5	158	–8.08	....	5
Defense—Military:									
Defense family housing improvement fund	19.23	40	208	25.34	150	592	28.40	215	757
Education:									
College housing and academic facilities loans	....	....	39	....	....	56	....	....	56
Federal direct student loan program	3.32	1,071	31,857	2.05	599	29,221	0.16	41	24,807
Homeland Security:									
Disaster assistance direct loan	....	....	....	73.17	750	1,025	1.18	....	25
Housing and Urban Development:									
FHA-mutual mortgage insurance	....	....	5	....	....	50	....	....	50
State:									
Repatriation loans	69.73	1	1	64.99	1	1	60.14	1	1
Contributions to international organizations	....	....	....	0.47	6	1,200	....	....	....
Transportation:									
Federal-aid highways	13.04	18	138	6.18	149	2,400	5.05	121	2,400
Railroad rehabilitation and improvement program	....	....	130	....	....	200	....	....	....
Treasury:									
Community development financial institutions fund	36.52	2	7	37.47	3	7	....	....	....
Veterans Affairs:									
Housing loans	–2.57	–5	165	5.08	19	384	2.93	17	605
Vocational rehabilitation program	1.14	....	3	1.59	....	3	2.00	....	4
International Assistance Programs:									
Debt restructuring	....	435	....	....	64	....	....	183	....
Overseas Private Investment Corporation	6.56	22	335	10.27	15	146	4.28	15	350
Small Business Administration:									
Disaster loans	12.86	163	1,271	14.64	671	4,587	13.18	118	900
Business loans	10.25	2	18	7.17	1	20	....	....	....
Export-Import Bank of the United States:									
Export-Import Bank loans	....	....	....	34.00	17	50	34.00	17	50
Total	**N/A**	**2,121**	**43,467**	**N/A**	**2,853**	**51,401**	**N/A**	**1,159**	**38,639**

[1] Additional information on credit subsidy rates is contained in the Federal Credit Supplement.
N/A = Not applicable.

Table 7–4. LOAN GUARANTEE SUBSIDY RATES, BUDGET AUTHORITY, AND LOAN LEVELS, 2005–2007

(in millions of dollars)

Agency and Program	2005 Actual			2006 Enacted			2007 Proposed		
	Subsidy rate [1]	Subsidy budget authority	Loan levels	Subsidy rate [1]	Subsidy budget authority	Loan levels	Subsidy rate [1]	Subsidy budget authority	Loan levels
Agriculture:									
Agricultural credit insurance fund	3.27	72	2,195	2.68	77	2,880	1.10	27	2,498
Commodity Credit Corporation export loans	5.07	152	3,001	4.13	128	3,107	3.61	115	3,167
Rural community advancement program	3.91	34	876	3.77	44	1,200	3.94	50	1,273
Rural electrification and telecommunications loans	....	....	....	0.09	....	99	....	....	....
Distance learning, telemedicine, and broadband program	....	....	....	....	....	....	4.63	1	30
Rural housing insurance fund	1.14	36	3,142	1.21	62	5,137	0.61	23	3,762
Rural business investment	....	....	....	7.72	5	65	....	....	....
Renewable energy	5.73	1	10	6.45	11	177	6.49	2	35
Defense—Military:									
Defense family housing improvement fund	6.06	10	165	....	....	....	....	....	....
Education:									
Federal family education loan	11.09	11,130	100,405	9.87	9,839	99,649	7.27	6,125	84,287
Health and Human Services:									
Health resources and services	5.35	1	17	3.50	1	15	....	....	....
Housing and Urban Development:									
Indian housing loan guarantee fund	2.58	3	103	2.42	2	116	2.35	6	251
Native Hawaiian housing loan guarantees	2.58	....	2	2.42	1	36	2.35	1	43
Native American housing	10.32	1	4	12.26	1	10	11.99	2	15
Community development loan guarantees	2.30	8	337	2.20	6	276	....	....	....
FHA-mutual mortgage insurance	–1.80	–1,044	58,017	–1.70	–839	[2] 48,594	–0.96	–845	[2] 86,039
FHA-general and special risk	–0.85	–169	19,652	–1.65	–282	[2] 17,165	–3.38	–247	[2] 7,370
Interior:									
Indian guaranteed loan	6.76	5	85	4.75	5	112	6.45	5	87
Transportation:									
Minority business resource center program	2.08	....	7	1.85	....	18	1.82	....	18
Federal-aid highways	....	....	....	3.67	7	200	3.90	8	200
Maritime guaranteed loans (Title XI)	27.54	38	140	7.64	5	65	....	....	....
Veterans Affairs:									
Housing loans	–0.32	–74	22,544	–0.32	–116	36,110	–0.30	–114	37,681
International Assistance Programs:									
Loan guarantees to Israel	....	....	750	....	....	1,000	....	....	1,000
Loan guarantees to Egypt	....	....	1,250	....	....	....	....	....	....
Development credit authority	5.09	10	199	3.90	10	257	5.49	13	238
Overseas Private Investment Corporation	–3.13	–53	1,694	–6.28	–64	1,025	–1.88	–30	1,600
Small Business Administration:									
General business loans	0.01	3	19,939	....	....	27,500	....	....	28,000
Export-Import Bank of the United States:									
Export-Import Bank loans	1.09	152	13,936	1.76	243	13,828	0.25	44	17,477
Presidio Trust:									
Presidio Trust	....	....	....	....	....	....	0.32	....	20
Total	**N/A**	**10,316**	**248,470**	**N/A**	**9,146**	**258,641**	**N/A**	**5,186**	**275,091**
ADDENDUM: SECONDARY GUARANTEED LOAN COMMITMENTS									
GNMA:									
Guarantees of mortgage-backed securities loan guarantee	–0.23	–218	112,519	–0.23	–205	[2] 89,000	–0.27	–235	[2] 86,000
SBA:									
Secondary market guarantee	....	....	10,000	....	....	12,000	....	....	12,000
Total, secondary guaranteed loan commitments	**N/A**	**–218**	**122,519**	**N/A**	**–205**	**101,000**	**N/A**	**–235**	**98,000**

[1] Additional information on credit subsidy rates is contained in the Federal Credit Supplement.
[2] Loan levels do not include standby commitment authority.
N/A = Not applicable.

Table 7–5. SUMMARY OF FEDERAL DIRECT LOANS AND LOAN GUARANTEES

(In billions of dollars)

	Actual								Estimate	
	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Direct Loans:										
Obligations	28.8	38.4	37.1	39.1	43.7	45.4	42.0	56.3	62.6	49.1
Disbursements	28.7	37.7	35.5	37.1	39.6	39.7	38.7	50.6	54.6	45.6
New subsidy budget authority	–0.8	1.6	–0.4	0.3	*	0.7	0.4	2.1	2.9	1.2
Reestimated subsidy budget authority [1]	7.3	1.0	–4.4	–1.8	0.5	2.9	2.6	3.8	3.3	....
Total subsidy budget authority	6.5	2.6	–4.8	–1.5	0.5	3.5	3.0	6.0	6.1	1.2
Loan guarantees:										
Commitments [2]	218.4	252.4	192.6	256.4	303.7	345.9	300.6	248.5	258.3	234.6
Lender disbursements [2]	199.5	224.7	180.8	212.9	271.4	331.3	279.9	221.6	240.6	245.7
New subsidy budget authority	3.3	*	3.6	2.3	2.9	3.8	7.3	10.1	8.9	5.0
Reestimated subsidy budget authority [1]	–0.7	4.3	0.3	–7.1	–2.4	–3.5	2.0	3.5	6.9	....
Total subsidy budget authority	2.6	4.3	3.9	–4.8	0.5	0.3	9.3	13.6	15.8	5.0

* Less than $50 million.

[1] Includes interest on reestimate.

[2] To avoid double-counting, totals exclude GNMA secondary guarantees of loans that are guaranteed by FHA, VA, and RHS, and SBA's guarantee of 7(a) loans sold in the secondary market.

Table 7–6. DIRECT LOAN WRITE-OFFS AND GUARANTEED LOAN TERMINATIONS FOR DEFAULTS

Agency and Program	In millions of dollars			As a percentage of outstanding loans [1]		
	2005 actual	2006 estimate	2007 estimate	2005 actual	2006 estimate	2007 estimate
DIRECT LOAN WRITEOFFS						
Agriculture:						
Agricultural credit insurance fund	132	135	135	1.84	2.04	2.16
Commodity Credit Corporation fund	24	....	....	1.15	....	....
Rural community advancement program	4	4	4	0.05	0.04	0.04
Rural development insurance fund	3	1	1	0.14	0.05	0.05
Rural housing insurance fund	90	113	108	0.35	0.45	0.44
P.L.480	61	189	....	0.69	2.30	....
Debt reduction (P.L.480)	4	....	....	0.76	....	....
Commerce:						
Economic development revolving fund	1	1	1	7.14	10.00	16.66
Education:						
Student financial assistance	6	6	6	1.85	1.85	1.85
Homeland Security:						
Disaster Assistant Direct Loan Program Account	127	....	....	97.69	....	....
Housing and Urban Development:						
Revolving fund (liquidating programs)	....	1	1	....	16.66	25.00
Guarantees of mortgage-backed securities	....	36	27	....	65.45	48.21
Interior:						
Indian direct loan	4	2	1	18.18	11.76	7.14
Labor:						
Pension benefit guaranty corporation fund	31	87	93	....	....	....
Veterans Affairs:						
Veterans housing benefit program	10	7	7	0.90	0.69	0.52
International Assistance Programs:						
Military debt reduction	7	....	....	2.76	....	....
Overseas Private Investment Corporation	....	8	8	....	1.29	1.08
Small Business Administration:						
Disaster loans	51	63	60	1.66	1.72	0.91
Business loans	....	4	2	....	2.18	1.22
Other Independent Agencies:						
Export-Import Bank	102	33	36	1.02	0.36	0.45
Debt reduction (ExIm Bank)	38	20	....	3.46	1.89	....
Spectrum auction program	3,346	....	418	77.56	....	96.53
Tennessee Valley Authority fund	1	1	1	1.88	2.08	1.85
Total, direct loan writeoffs	4,042	711	909	1.84	0.32	0.38
GUARANTEED LOAN TERMINATIONS FOR DEFAULT						
Agriculture:						
Agricultural credit insurance fund	61	58	58	0.58	0.56	0.54
Commodity Credit Corporation export loans	190	163	181	4.53	6.62	6.02
Rural community advancement program	87	101	117	1.86	2.14	2.30
Rural electrification and telecommunications loans	....	3	3	....	0.66	0.56
Rural housing insurance fund	260	275	280	1.87	1.87	1.69
Defense—Military:						
Procurement of ammunition, Army	....	8	....	....	30.76	....
Family housing improvement fund	....	5	6	....	1.23	1.50
Education:						
Federal family education loan	4,724	5,527	6,320	1.92	1.91	1.88
Health and Human Services:						
Health education assistance loans	23	29	26	0.95	1.69	1.82
Housing and Urban Development:						
Indian housing loan guarantee	....	4	4	....	2.08	2.00
Title VI Indian Federal guarantees program	....	1	2	....	1.25	2.38
FHA—Mutual mortgage insurance	6,757	6,463	6,639	1.76	1.92	1.98
FHA—General and special risk	1,408	2,394	1,138	1.55	2.66	1.27
Interior:						
Indian guaranteed loan	3	1	1	0.89	0.31	0.30

Table 7–6. DIRECT LOAN WRITE-OFFS AND GUARANTEED LOAN TERMINATIONS FOR DEFAULTS—Continued

Agency and Program	In millions of dollars			As a percentage of outstanding loans [1]		
	2005 actual	2006 estimate	2007 estimate	2005 actual	2006 estimate	2007 estimate
Transportation:						
Maritime guaranteed loan (Title XI)	....	35	35	....	1.12	1.15
Treasury:						
Air transportation stabilization program	125	9	....	7.33	0.94	....
Veterans Affairs:						
Veterans housing benefit program	1,076	2,628	2,515	0.30	1.27	1.22
International Assistance Programs:						
Micro and small enterprise development	1	1	1	1.31	7.14	9.09
Urban and environmental credit program	33	21	29	1.79	1.27	1.87
Development credit authority	....	1	2	....	0.59	0.72
Overseas Private Investment Corporation	38	45	45	0.98	1.25	1.25
Small Business Administration:						
General business loans	1,551	1,903	2,102	2.69	2.59	2.53
Pollution control equipment	....	1	....	....	25.00	....
Other Independent Agencies:						
Export-Import Bank	182	211	253	0.50	0.58	0.64
Total, guaranteed loan terminations for default	16,519	19,887	19,757	0.98	1.31	1.27
Total, direct loan writeoffs and guaranteed loan terminations	20,561	20,598	20,666	1.08	1.19	1.15
ADDENDUM: WRITEOFFS OF DEFAULTED GUARANTEED LOANS THAT RESULT IN LOANS RECEIVABLE						
Agriculture:						
Agricultural credit insurance fund	3	1	1	7.69	2.85	2.85
Commerce:						
Federal ship financing fund	1	....	....	4.17	....	....
Education:						
Federal family education loan	863	1,006	1,071	4.02	4.52	4.72
Housing and Urban Development:						
FHA—Mutual mortgage insurance	....	10	1	....	1.84	1.72
FHA—General and special risk	226	8	6	4.80	0.13	0.08
Interior:						
Indian guaranteed loan	4	2	2	25.00	15.38	18.18
Treasury:						
Air transportation stabilization program	....	102	....	....	76.11	....
International Assistance Programs:						
Overseas Private Investment Corporation	84	4	3	38.35	2.56	1.47
Small Business Administration:						
Business loans	221	276	276	5.02	4.47	3.74
Pollution control equipment	29	....	....	59.18	....	....
Other Independent Agencies:						
Export-Import Bank	51	....	....	25.37	....	....
Total, writeoffs of loans receivable	1,482	1,409	1,360	3.64	3.53	3.22

[1] For direct loans and loan guarantees, outstanding loans equal the start of year outstanding balance plus new disbursements. For loans receivable, outstanding loans equal start of year outstanding balance plus terminations for default resulting in loans receivable.

Table 7–7. APPROPRIATIONS ACTS LIMITATIONS ON CREDIT LOAN LEVELS [1]

(In millions of dollars)

Agency and Program	2005 Actual	2006 Actual	2007 Estimate
DIRECT LOAN OBLIGATIONS			
Agriculture:			
Agricultural credit insurance fund	1,112	953	930
P.L. 480 direct credit	30	30	....
Commerce:			
Fisheries finance	91	64	5
Education:			
Historically black college and university capital financing	193	222	170
Homeland Security:			
Disaster assistance direct loans	25	1,025	25
Housing and Urban Development:			
FHA-general and special risk	50	50	50
FHA-mutual mortgage insurance	50	50	50
State:			
Repatriation loans	1	1	1
Loan for renovation of UN Headquarters	....	1,200	....
Treasury:			
Community development financial institutions fund	11	11	....
Veterans Affairs:			
Native American loans	50	30	30
Vocational rehabilitation	3	3	4
Small Business Administration:			
Business loans	18	20	....
Total, limitations on direct loan obligations	1,634	3,659	1,265
LOAN GUARANTEE COMMITMENTS			
Agriculture:			
Agricultural credit insurance fund	2,201	2,797	2,498
Housing and Urban Development:			
Indian housing loan guarantee fund	145	99	104
Title VI Indian federal guarantees	18	18	15
Native Hawaiian housing loan guaranteed	37	35	35
Community development loan guarantees	275	138	....
FHA-general and special risk	35,000	35,000	35,000
FHA-mutual mortgage insurance	185,000	185,000	185,000
Interior:			
Indian loans	85	112	87
Transportation:			
Minority business resource center	18	18	18
Maritime guaranteed loan (Title XI)	140	65	....
Veterans Affairs:			
Housing loans	....	1	....
International Assistance Programs:			
Loan guarantees to Israel	3,000	....	....
Development credit authority	....	700	700
Loan guarantees to Egypt	2,000	....	....
Small Business Administration:			
General business loans	19,939	27,500	28,000
Total, limitations on loan guarantee commitments	247,858	251,483	251,457
ADDENDUM: SECONDARY GUARANTEED LOAN COMMITMENT LIMITATIONS			
Housing and Urban Development:			
Guarantees of mortgage-backed securities	200,000	200,000	100,000
Small Business Administration:			
Secondary market guarantee	10,000	12,000	12,000
Total, limitations on secondary guaranteed loan commitments	210,000	212,000	112,000

[1] Data represents loan level limitations enacted or proposed to be enacted in appropriation acts. For information on actual and estimated loan levels supportable by new subsidy budget authority requested, see Tables 7–3 and 7–4.

Table 7–8. FACE VALUE OF GOVERNMENT-SPONSORED LENDING [1]

(In billions of dollars)

	Outstanding	
	2004	2005
Government Sponsored Enterprises		
Fannie Mae [2]	N/A	N/A
Freddie Mac [3]	1,481	N/A
Federal Home Loan Banks [4]	N/A	N/A
Farm Credit System	87	92
Total	**N/A**	**N/A**

N/A = Not available.

[1] Net of purchases of federally guaranteed loans.

[2] Financial data for Fannie Mae is not presented here because Fannie Mae announced in December 2004 that it would have to restate financial results for 2001–2004. The restatement is not likely to be completed prior to the second half of calendar year 2006.

[3] While financial data for 2004 is presented here, Freddie Mac announced on November 8, 2005 that it would reduce net income for the first half of calendar year 2005 and expects to release full-year 2005 results by March 2006.

[4] Financial data for the Federal Home Loan Banks are not presented here because following discussions with the Securities and Exchange Commission, six of the twelve Federal Home Loan Banks have announced their intent to restate their 2001–2004 financial statements.

Table 7–9. LENDING AND BORROWING BY GOVERNMENT-SPONSORED ENTERPRISES (GSEs)

(In millions of dollars)

Enterprise	2005
LENDING [1]	
Federal National Mortgage Association: [2]	
Portfolio programs:	
Net change	N/A
Outstandings	N/A
Mortgage-backed securities:	
Net change	N/A
Outstandings	N/A
Federal Home Loan Mortgage Corporation: [3]	
Portfolio programs:	
Net change	N/A
Outstandings	N/A
Mortgage-backed securities:	
Net change	N/A
Outstandings	N/A
Farm Credit System:	
Agricultural credit bank:	
Net change	1,853
Outstandings	25,121
Farm credit banks:	
Net change	6,039
Outstandings	66,802
Federal Agricultural Mortgage Corporation:	
Net change	–423
Outstandings	5,126
Federal Home Loan Banks: [4]	
Net change	N/A
Outstandings	N/A
Less guaranteed loans purchased by:	
Federal National Mortgage Association: [2]	
Net change	N/A
Outstandings	N/A
Other: [4]	
Net change	N/A
Outstandings	N/A
BORROWING [1]	
Federal National Mortgage Association: [2]	
Portfolio programs:	
Net change	N/A
Outstandings	N/A
Mortgage-backed securities:	
Net change	N/A
Outstandings	N/A
Federal Home Loan Mortgage Corporation: [3]	
Portfolio programs:	
Net change	N/A
Outstandings	N/A
Mortgage-backed securities:	
Net change	N/A
Outstandings	N/A
Farm Credit System:	
Agricultural credit bank:	
Net change	1,840
Outstandings	28,466
Farm credit banks:	
Net change	9,549
Outstandings	81,361
Federal Agricultural Mortgage Corporation:	
Net change	504
Outstandings	3,928
Federal Home Loan Banks: [4]	
Net change	N/A

Table 7–9. LENDING AND BORROWING BY GOVERNMENT-SPONSORED ENTERPRISES (GSEs)—Continued

(In millions of dollars)

Enterprise	2005
Outstandings	N/A
DEDUCTIONS [1]	
Less borrowing from other GSEs: [5]	
Net change	N/A
Outstandings	N/A
Less purchase of Federal debt securities: [5]	
Net change	N/A
Outstandings	N/A
Federal National Mortgage Association: [2]	
Net change	N/A
Outstandings	N/A
Other: [5]	
Net change	N/A
Outstandings	N/A

N/A = Not available.

[1] The estimates of borrowing and lending were developed by the GSEs based on certain assumptions that are subject to periodic review and revision and do not represent official GSE forecasts of future activity, nor are they reviewed by the President. The data for all years include programs of mortgage-backed securities. In cases where a GSE owns securities issued by the same GSE, including mortgage-backed securities, the borrowing and lending data for that GSE are adjusted to remove double-counting.

[2] Financial data for Fannie Mae is not presented here because Fannie Mae announced in December 2004 that it would have to restate financial results for 2001–2004. The restatement is not likely to be completed prior to the second half of calendar year 2006.

[3] Freddie Mac announced on November 8, 2005 that it would reduce net income for the first half of calendar year 2005 and expects to release full-year 2005 results by March 2006.

[4] Financial data for the Federal Home Loan Banks are not presented here because following discussions with the Securities and Exchange Commission, six of the twelve Federal Home Loan Banks have announced their intent to restate their 2001–2004 financial statements.

[5] Totals and subtotals have not been calculated because a substantial portion of the total is subject to the above-described restatements.

8. AID TO STATE AND LOCAL GOVERNMENTS [1]

State and local governments have a vital constitutional responsibility to provide government services. They have the major role in providing domestic public services, such as public education, law enforcement, roads, water supply, and sewage treatment. The Federal Government contributes to that role by promoting a healthy economy. It also provides grants, loans, and tax subsidies to State and local governments.

Federal grants help State and local governments finance programs covering most areas of domestic public spending, including income support, infrastructure, education, and social services. Federal grant outlays were $426.2 billion in 2005 and are estimated to be $449.3 billion in 2006 and $459.0 billion in 2007.

Grant outlays to State and local governments for payments to individuals, such as Medicaid payments, are estimated to be 65 percent of total grants in 2007; grant outlays for physical capital investment, 15 percent; and grant outlays for all other purposes, largely education, training, and social services, 20 percent.

Some tax expenditures also constitute Federal aid to State and local governments. Tax expenditures stem from special exclusions, exemptions, deductions, credits, deferrals, or tax rates in the Federal tax laws.

The deductibility of State and local personal income and property taxes from gross income for Federal income tax purposes and the exclusion of interest on State and local public purpose bonds from Federal taxation comprise the two largest categories of tax expenditures benefiting State and local governments. These provisions, are estimated to be worth $76.9 billion in 2007. Chapter 19, "Tax Expenditures," of this volume provides a detailed discussion of the measurement and definition of tax expenditures and a complete list of the estimated costs of specific tax expenditures. As discussed in that chapter, there are generally interactions among tax expenditure provisions, so that the total cost estimates only approximate the aggregate effect of these provisions. Tax expenditures that especially aid State and local governments are displayed separately at the end of Tables 19–1 and 19–2.

This chapter also includes information on the performance of selected grant programs based on the Program Assessment Rating Tool. An Appendix to this chapter includes State-by-State estimates of major grant programs.

Table 8–1. FEDERAL GRANT OUTLAYS BY AGENCY

(In billions of dollars)

Agency	2005 Actual	Estimate	
		2006	2007
Department of Agriculture	24.7	26.6	26.5
Department of Commerce	0.6	0.6	0.5
Department of Education	39.5	41.8	41.0
Department of Energy	0.3	0.3	0.3
Department of Health and Human Services	245.0	258.5	264.3
Department of Homeland Security	14.0	14.3	13.9
Department of Housing and Urban Development	35.4	38.5	38.5
Department of the Interior	4.0	4.7	4.7
Department of Justice	4.2	3.2	4.3
Department of Labor	7.6	7.3	7.0
Department of Transportation	43.4	46.7	51.5
Department of the Treasury	0.5	0.5	0.5
Department of Veterans Affairs	0.1	0.1	0.1
Environmental Protection Agency	3.7	3.7	3.7
Other agencies	3.1	2.4	2.2
Total	426.2	449.3	459.0

Table 8–1 shows the distribution of grants by agency. Grant outlays by the Department of Health and Human Services are estimated to be $264.3 billion in 2007, 58 percent of total grant outlays.

HIGHLIGHTS OF THE FEDERAL AID PROGRAM

Several proposals in this budget affect Federal aid to State and local governments and the important relationships between the levels of government. Through the use of grants, the Federal Government shares with State and local governments the cost and, ultimately, the benefits of a better educated, healthier, and safer citizenry. The Administration intends to work with State and local governments to make the Federal system more efficient and effective and to improve the design, administration, and financial management of Federal grant programs.

In programs where the Federal Government and State and local governments partner in the provision of services, State and local government involvement is critical to improving the performance of Federal programs. To date, the Administration has rated the effectiveness of about four fifths of all Federal programs using the Program Assessment Rating Tool (PART). On average, grant programs received lower ratings than other types of programs, which suggests the need for strengthening partnerships and accountability for achieving program outcomes.

[1] Federal aid to State and local governments is defined as the provision of resources by the Federal Government to support a State or local program of governmental service to the public. The primary forms of aid are grants, (including loan subsidies), and tax expenditures.

In support of the Administration's initiative to identify and eliminate improper payments, managers of several programs jointly administered by the Federal Government and the States, including Medicaid and the School Lunch program, are developing methodologies to estimate the extent of improper payments, identify the causes and remedy them. The passage of the Improper Payments Information Act (IPIA) of 2002 codified the goals of the President's initiative to enhance the accuracy and integrity of Federal payments. The IPIA, and subsequent OMB implementing guidance, established a framework for agencies to (i) review every Federal program, activity, and dollar to assess risk of significant improper payments; (ii) develop a statistically valid estimate to measure the extent of improper payments in risk susceptible Federal programs; (iii) initiate process and internal control improvements to enhance the accuracy and integrity of payments; and (iv) report and assess progress on an annual basis. In 2004, all agencies began to develop and implement plans to comply with these expanded reporting requirements. As these efforts continue in 2006 and beyond, the Federal government is strengthening its position to make significant strides in identifying and eliminating improper payments.

In addition, under the auspices of the Federal Financial Assistance Management Improvement Act of 1999 (PL 106–107) and the Administration's *Grant.gov* and Grants Management Line of Business Initiatives, Federal grant making agencies have continued to work individually and collectively to improve and streamline the efficiency of administering grant programs and to achieve the vision of a Government-wide solution that supports end-to-end grants management activities. The goals are to promote grantee access, customer service, and agency financial and technical stewardship. Particularly, in 2005, the Federal Government has realized its objectives to:

- Establish a simple, unified "storefront" for all customers to find and apply for grants (called FIND and APPLY). Federal departments and agencies posted 2,259 funding opportunities for discretionary Federal assistance on *Grants.gov* FIND and 994 of those opportunities were available for electronic application submission via *Grants.gov* APPLY.
- Develop a business-driven, common solution for grants management to improve customer access to Federal information and support. The Grants Management Line of Business task force identified a "consortia-based" approach to streamlining grants management: align agency work teams (consortia) around shared business interests and process grants in a decentralized way using common business processes.
- Establish a single location in the Code of Federal Regulations (Title 2 CFR) to place all the Government-wide and agency guidance regarding grants management;
- Create a Grants Policy Committee under the CFO (chief financial officer) council that will ensure the continued progress of the streamlining efforts.

Highlights of grants to State and local governments are presented below. For additional information on grants, see Table 8–4 in this chapter, and discussions in the main budget volume.

Homeland Security

Since 2001, this Administration has provided Federal agencies with $31 billion in funding to State, local, and tribal governments to enhance their responder capabilities, including $22 billion focused on homeland security preparedness for terrorism and other catastrophic events.

To improve coordination and provide additional assistance to State and local law enforcement officials, the Budget includes $4 million for additional personnel for the Department of Homeland Security's (DHS) Law Enforcement Support Center that checks and validates immigration status inquiries for State/local law enforcement.

Public safety personnel at the State, local, and tribal level are vital partners in improving the Nation's homeland security. Over the last five years, DHS has provided $13.9 billion in grants and training to enhance the Nation's homeland security preparedness.

In addition, this budget proposes to expand a successful Federal/State partnership—the 287(g) program—which provides State/local law enforcement officials with guidance and training in immigration law. The program helps State/local law enforcement agencies identify aliens who are in prison or applying for driver's licenses with fraudulent documents. It also assists in State investigations and aids in the detention and removal of those here illegally. Proposed funding includes $60 million to increase the number of fugitive operation teams that identify, locate, and apprehend immigration fugitives, and $10 million to hire 69 new compliance enforcement agents to ensure that visitors who enter our country legally, also leave the country when their visas expire.

The President's 2007 Budget continues this progress through multi-tiered investments. The requested funding level of $840 million for Urban Area Security Grants increases grant funding for those metropolitan regions most at risk due to their concentrations of citizens and key assets. The request for $593 million in Targeted Infrastructure Protection grants integrates disparate programs for securing transportation assets and other critical infrastructures. The Administration will work more closely with Congress to gain support for this request, which was not funded in 2006. A total of $840 million is requested for State-based grants, including $637 million for State Homeland Security Grants, $168 million for Emergency Management Performance Grants, and $35 million for Citizen Corps. The proposed reduction of $303 million from 2006 reflects PART findings on the significant funding provided over the four years, and a reprioritization towards other

DHS programs. As identified in the PART process, it has been difficult to measure the impact and results of the $6.7 billion awarded for these programs over 2002–2005.

In the event of a national emergency it is crucial that first responders, State and local governments, and the Federal Government are able to communicate with each other. The 2007 Budget recognizes the importance of this goal. The Administration created SAFECOM in 2001 as a Government-wide initiative to improve interoperability, and over the last three years Federal agencies (mainly DHS) have provided over $2 billion in grants for interoperability. However, the lack of standards has hampered efforts to move forward. In 2007 DHS will set basic interoperability standards so that Federal grant dollars can be better used to ensure that our Nation's first responders can communicate in an emergency.

Natural Resources and Environment

The Clean Water State Revolving Fund (SRF) provides grants to States to capitalize their municipal wastewater State revolving funds. States provide matching funds and then make loans to communities at below-market rates for wastewater infrastructure projects such as sewer rehabilitation and treatment plant expansion. Loan repayments and interest are recycled back into the program.

This Budget continues to support State and tribal efforts to improve water quality though the Clean Water (SRF). In the 2004 Budget, the President proposed funding the Clean Water SRF at $850 million annually for 2004–2011, for $6.8 billion in total funding. Due to significant additional funds appropriated in 2004–2006, the 2007 Budget proposes to reduce annual funding for the Clean Water SRF to $688 million for 2007–2011. At this funding level, the Budget meets the 2004 capitalization commitment, ensuring communities have access to capital to finance their wastewater infrastructure needs. This funding level will still allow the Clean Water SRF to meet its long-term revolving level goal of $3.4 billion. The revolving level is the amount of loans available annually over the long-term after Federal capitalization ends, and an indicator of the Clean Water SRF's financial stability

The 2007 Budget supports key programs in the Commerce Department's National Oceanic and Atmospheric Administration (NOAA) that promote stewardship of our ocean, coastal, and Great Lakes resources. The President's U.S. Ocean Action Plan, released in December 2004, emphasized the importance of strong partnerships between Federal, State, Tribal, and local governments in effectively managing these resources. New investments and program improvements within NOAA are aimed at strengthening our knowledge and management of these resources in support of the U.S. Ocean Action Plan. For example, proposed reforms to the Coastal Zone Management Program will increase the competitiveness of grants to better target funding to support State, regional, and national priorities.

Transportation

Grants support State and local programs for highways, mass transit, and airports. Grant outlays to State and local governments for transportation are estimated to be $51.5 billion in 2007.

In August, 2005, the President signed into law the "Safe, Accountable, Flexible, and Efficient Transportation Equity Act: A Legacy for Users" (SAFETEA–LU). With funding for highways, highway safety, and public transportation totaling $286 billion for 2004 through 2009, SAFETEA–LU represents the largest surface transportation investment in our Nation's history. SAFETEA–LU addresses a variety of surface transportation issues, such as advancing highway safety, easing traffic congestion, and enhancing public transportation, as well as laying the groundwork to address future challenges.

As part of SAFETEA–LU, the Department of Transportation (DOT) seeks to enhance highway safety by improving the design and condition of the highways themselves. SAFETEA–LU dedicated $5.1 billion through 2009 for highway safety programs administered by the Federal Highway Administration, including State grants aimed at eliminating hazardous roadway conditions. Specifically, SAFETEA–LU authorized a new $1.3 billion core Highway Safety Improvement Program that will distribute formula funds to all States. Other highway safety programs target particular areas of concern such as work zones, older drivers, and pedestrians.

Community and Regional Development

Strengthening America's Communities Initiative. The 2007 Budget proposes to reform and improve the Federal Government's economic development activities by consolidating duplicative programs and targeting funding to those communities most in need. To carry out these principles, the Budget proposes to implement the Strengthening America's Communities Initiative (SACI) in the Departments of Commerce and Housing and Urban Development (HUD). This reform grew out of a cross-cutting performance review of these programs a year ago, and was further informed by the report of the Strengthening America's Communities Advisory Committee in July 2005.

The Budget would reform HUD's Community Development Block Grant (CDBG) program by directing more of CDBG's base funding to communities that cannot meet their own needs. In addition, bonus funds would be awarded to those who demonstrate the greatest progress in expanding ownership and opportunity for their residents. HUD programs that duplicate the purposes of CDBG—Brownfields Redevelopment grants, Rural Housing and Economic Development, and Section 108 Loan Guarantees—will be consolidated with CDBG as part of this reform. HUD's Youthbuild program is proposed for transfer to the Department of Labor, where it can be administered more effectively.

Implementing SACI in the Department of Commerce will give the Economic Development Administration

(EDA) a new focus on providing funding to communities who incorporate promising regional strategies to bring investment and growth into distressed areas. These projects will be multi-jurisdictional in nature, and EDA will develop new performance measures to track the results of its assistance in supporting innovation-led regional strategies. The 2007 Budget also provides funding for EDA to assist communities affected by the recent Base Realignment and Closure Commission decisions.

Other Federal programs that support local development will operate with CDBG and EDA within a new broader framework of clear goals, cross-cutting community progress indicators, and common standards for the award of bonus and competitive funding.

Education

Grant budget authority requested for elementary, secondary, and vocational education is $36.4 billion in 2007.

Leaving No Child Behind. At the center of the President's commitment to education is his promise to "leave no child behind." When President Bush launched his No Child Left Behind initiative, he said, "The Federal role in education is not to serve the system. It is to serve the children." No Child Left Behind (NCLB) is making a difference for every child, in every public school. It is no longer acceptable for any child to slip through the cracks or fail to receive the challenging education he or she deserves. Schools are held accountable for ensuring that all children, including those who are disadvantaged or have a disability, become proficient in reading and math. Parents receive detailed information about the performance of their schools. Students who attend low-performing schools have the option to attend a better public school or, if their schools do not improve, to receive tutoring funded by the school district. The largest program that assists elementary and secondary education is Title I Grants to Local Educational Agencies. Title I provides funds to schools in low-income communities and is the foundation for the NCLB accountability, school improvement, and parental choice reforms. The Budget requests $12.8 billion for Title I, a $100 million increase over the 2006 level, a 45 percent increase since 2001. The entire increase will be devoted to schools in need of improvement, specifically schools that have not met their NCLB student achievement goals for at least two years. This will ensure that States and school districts are able to receive the assistance needed to improve low-performing schools.

- *Teachers.* Well-trained, highly qualified teachers are critical to student learning. The major source of Federal support for addressing this challenge is the Improving Teacher Quality State Grants program. The Budget provides $2.9 billion for this program to support teacher training and recruitment, assists States in meeting NCLB teacher quality requirements and ensures every class is taught by a qualified teacher. Recognizing both the importance and the challenges of finding and training qualified teachers, especially in subjects such as math and science, the Budget provides $99 million for the Teacher Incentive Fund, the same as 2006, and $25 million for the creation of an Adjunct Teacher Corps.

Improving Performance for Special Education Students. On December 3, 2004, the President signed into law the Individuals with Disabilities Education Improvement Act of 2004. This Act made several changes that will help redefine how States and schools identify children with disabilities, set assessments standards, and strengthen the contents of student's individualized education programs (IEPs). The new IDEA also adopts NCLB's highly qualified teacher standards for those teaching core subjects, while providing flexibility for States, school districts, and new teachers of multiple subjects. Over the past year, the Department has undertaken an elaborate and thorough process to clarify the law's provisions and to consider significant numbers of public comments before it finalizes the implementing regulations.

The newly reauthorized IDEA refocuses special education programs on student outcomes and will require States to establish performance plans and implement programs to meet their performance goals. These improvements will advance the progress that has already been seen in several key areas. The 2005 Nation's scorecard and the Department's Office of Special Education Programs have reported the following progress:

- The percentage of fourth-grade students with disabilities scoring at or above Basic in reading has increased from 22 percent in 2000 to 33 percent in 2005 and the percentage of eighth-grade students scoring at or above Basic in mathematics increased from 20 percent in 2000 to 31 percent in 2005.
- The percentage of students with disabilities who graduate from high school with a regular high school diploma increased from 46 percent in 2000 to 54 percent in 2004, while the percentage of students who dropped out of school decreased from 42 percent in 2000 to 31 percent in 2005.

From 2001 to 2006, funding for IDEA Grants to States increased by 67 percent, from $6.3 billion to $10.6 billion. The 2007 Budget provides an additional $100 million for States to maintain this positive trajectory and provide a high quality education to the nearly 7 million IDEA students.

Training and Employment

Training Workers for the Jobs of the 21st Century. The President wants to ensure that the United States meets the training challenge brought on by the growth in industries requiring high-skilled workers and has proposed initiatives and reforms intended to make the Nation's workforce training more responsive to the needs of workers and employers in the 21st Century. The Administration and the Congress have worked together to enact three of these programs:

- *High Growth Job Training Initiative.* In 2002, the Administration began this initiative as a pilot to prepare workers for the jobs being created in high growth industries. Through 2005, $256 million in State and local grants went to 130 partnerships of training providers, employers, and the workforce system. In December 2004, legislation was enacted to permanently authorize the program and finance it through fees that employers pay when they submit visa applications for high skilled foreign workers to work in the United States. The 2007 Budget provides $125 million for this program, which will train an estimated 50,000 U.S. workers and help meet American industries' need for qualified, skilled employees.
- *Community-Based Job Training Grants.* The 2007 Budget continues the President's commitment to this initiative, which he introduced in the 2005 Budget. Community and technical colleges, working in conjunction with local industries, are a powerful economic development tool. They are accessible to many workers and job seekers who need the education and skills training to improve employment and earnings. In addition, these colleges are well positioned to respond to local employers and help train workers for jobs that are available in their community and region. In October 2005, the Department awarded the first 70 competitive grants, totaling $125 million, through this Presidential initiative. The 2007 Budget provides $150 million, $26 million (21 percent) more than 2006 funding, to train an estimated 60,000 workers.
- *Community-based Job Training Grants.* The 2007 Budget continues the President's commitment to the Community College Initiative (CCI), first introduced in the 2005 Budget. Community and technical colleges, working in conjunction with local industries, are a powerful economic development tool. They are easily accessible to many workers and job seekers and provide education and skills training aimed at expanding opportunities for their students. In addition, these colleges are well positioned to respond to local employers and help train workers for jobs that are available in their community and region. In October 2005, the Department awarded the first 70 competitive grants, totaling $125 million, through this Presidential initiative. The 2007 Budget provides $150 million, $26 million (21 percent) more than 2006 funding, to train an estimated 60,000 workers.

Social Services

Head Start. The Budget supports reauthorization of Head Start and provides $6.8 billion in budget authority for 2007, enough to serve more than 900,000 children.

Child Welfare Program Option. This Budget seeks legislation to introduce an option for all States so they can choose an alternative system for foster care. Flexible financing will allow States to design programs with a stronger emphasis on child-abuse prevention, family support, and increased flexibility in providing services.

Health

Medicaid and the State Children's Health Insurance Program (SCHIP). In 2007, Federal Medicaid funding is estimated to be $199 billion. Medicaid is an open-ended means-tested entitlement program that is financed jointly by the Federal Government and States. Medicaid provides health coverage and services to nearly 53 million low-income children, pregnant women, elderly persons, and disabled individuals during the year.

SCHIP was established in 1997 to make available approximately $40 billion over 10 years for States to provide health-care coverage to low-income, uninsured children who did not qualify for Medicaid. Since the beginning of the Administration, total enrollment in SCHIP has grown by an estimated 1.5 million children, to a total of approximately 6.1 million in 2004. Current law rules for distributing SCHIP funds can lead to shortfall in some States. The 2007 Budget will seek authority to target SCHIP funds more efficiently to States with the most need.

- *Transitional Medical Assistance* The Deficit Reduction Act enhances services for former welfare recipients by extending Transitional Medical Assistance (TMA) through December 31, 2006. This program provides coverage for former welfare recipients entering the workforce, and the Administration proposes extending the program through September 30, 2007.
- *Cover the Kids*. The 2007 Budget proposes Cover the Kids, a national outreach campaign. This initiative will provide $100 million in grants annually to enroll additional Medicaid- and SCHIP-eligible children by combining the resources of the Federal Government, States, schools, and community organizations.
- *Grants to States for the Chronically Ill*. Chronically ill individuals often struggle to secure health insurance coverage. The 2007 Budget proposes to create a competitive grant program whereby States compete to receive funds to implement innovative policies to promote insurance among the chronically ill. For this effort, $500 million would be available annually.
- *Health Insurance Portability and Accountability Act (HIPAA*). Since enacted in 1996, HIPAA has increased the continuity, portability, and accessibility of health insurance. To ensure that Medicaid and SCHIP beneficiaries receive the benefits of HIPAA coverage, the Administration proposes two legislative changes: 1) Eligibility for a Medicaid/SCHIP Employer-Sponsored Insurance (ESI) Program would be a qualifying event allowing families to enroll in ESI immediately through special enrollment; and 2) Require SCHIP programs to issue certificates of creditable coverage promoting portable health coverage by verifying the period

of time an individual was covered by a specific health insurance policy.

- ***Health Centers.*** Locally run Health Centers deliver high-quality, affordable primary and preventive health care to nearly 14 million patients at 3,700 sites across the United States annually. Health Centers focus on providing care to low-income individuals and those without health insurance. Patients are charged for services based on their ability to pay. An assessment of the program found that it is effective in reducing hospitalization rates and treating the uninsured. Approximately 86 percent of Health Center patients are at or below 200 percent of the Federal poverty line. Since the President began his commitment to expand services through Health Centers, 777 Health Center sites have been established or expanded and 3.7 million more people per year are being served. An estimated 120 new and expanded sites will be created in 2006.

  The 2007 Budget continues this record of progress and will complete the President's commitment to create 1,200 new or expanded Health Center sites. More than 1.2 million additional individuals will receive health care in 2007 through more than 300 new or expanded sites in rural areas and underserved urban neighborhoods. Included in the President's commitment is the goal to create a Health Center in every poor county in America that lacks a Health Center and can support one. Of the new sites created in 2007, 80 will be in high-poverty counties that lack a Health Center. Faith-based and community programs will also be encouraged to compete for these grants.

Income Security

Food and Nutrition Assistance. As part of its diverse array of programs, the United States Department of Agriculture (USDA) delivers programs that help those in need.

The Special Supplemental Nutrition Program for Women, Infants and Children, more commonly known as WIC, serves the nutritional needs of low-income pregnant and post partum women, infants and children up to their fifth birthday. The Budget provides $5.2 billion for WIC services in 2006, full funding for all those estimated to be eligible and seeking services.

Housing Assistance. Grant outlays for housing assistance are estimated to be $31.4 billion in 2007.

Ending Chronic Homelessness. The Administration remains committed to the goal of ending chronic homelessness. Chronically homeless individuals who live on the streets and in shelters for long periods comprise less than 10 percent of the homeless population, yet consume over half of emergency homeless services. Many of this group have an addiction and/or suffer from a disabling physical or mental condition. As a result, they are homeless for extended periods of time or experience multiple episodes of homelessness. Housing this population will free Federal, State, and local emergency resources for families and individuals who need shorter-term assistance.

Through efforts of the U.S. Interagency Council on Homelessness, the Administration's initiative to end chronic homelessness has gained traction in communities large and small across the country. Fifty-three States and territories have established interagency councils on homelessness, and over 200 cities and counties have established 10-year plans to end chronic homelessness. Federal interagency efforts to end chronic homelessness continue with the Departments of Health and Human Services (HHS), Veterans Affairs, and Labor participating actively.

This budget proposes a $135 million increase for HUD's Homeless Assistance grants, which received an Effective Rating in this year's PART assessment due to a good program design and strong performance measures. The increase will help continue the work of the Samaritan Initiative that has integrated the efforts of State, local, private and other Federal programs to create and run 50,000 new units of supportive housing across the country for the chronically homeless. Up to $200 million is available for the Samaritan Initiative within the Homeless Assistance Grants annual competition.

Temporary Assistance for Needy Families (TANF). This program provides grants to States for programs that assist needy families with children. Since the reformed welfare program was created in 1996, the number of welfare recipients has continued to decrease, and employment and earnings among the target population have increased. This is reflected in the PART evaluation, where the program received a rating of Moderately Effective, because it was able to demonstrate the program's impact with performance measures and independent evaluations. The program's recent reauthorization maintains the funding level, strengthens work requirements to maximize self-sufficiency, and supports healthy marriage and family formation.

Administration of Justice

This Budget includes $1.9 billion for State and local assistance programs, including Project Safe Neighborhoods, the DNA Initiative, USA Freedom Corps, the Regional Information Sharing System (RISS), Methamphetamine Lab Cleanup, and other initiatives. These and other Department of Justice (DOJ) programs enhance the capability of State and local governments to reduce crime in our communities, reduce domestic violence, assist victims of crime, and reduce our vulnerability to terrorism.

Today, violent crime is at its lowest rate in at least three decades, decreasing 2.2 percent in 2004. The Project Safe Neighborhoods (PSN) initiative, announced by the President and the Attorney General in 2001, has helped bring together Federal, State, and local resources to help stamp out firearms-related crime in our communities. Beginning in 2007, PSN will become a more robust strategy that targets not just illegal gun crime, but also the violent gangs that plague some of our communities. Since 2001, the Administration has dedicated over $1.5 billion in Federal resources to PSN, including grants to State and local task forces through the Office of Justice Programs (OJP), increased Federal prosecutors in U.S. Attorneys Offices, and agents and training within the Bureau of Alcohol, Tobacco, and Firearms (ATF). For 2007, the Budget requests $395 million for PSN, an increase of $154 million, or 64 percent, over the 2006 enacted level. The program increase will:

- Provide $59 million in grant assistance for State and local prosecution of criminal misuse of firearms and illegal gang activity;
- Increase funding for States to update criminal history records, which are needed to deter illegal firearms purchases, by $29 million—almost four times the 2005 enacted level;
- Make available $15 million in technical assistance to State and local law enforcement to assist in combating gangs; and
- Permit the deployment of ATF Violent Crime Impact Teams to 15 additional cities to assist States/localities in combating violence.

Other Functions

Discussions of these and other Federal aid programs can be found in the main budget volume and elsewhere. As noted earlier, a detailed listing of budget authority and outlays for all grants to State and local governments is in Table 8–4 in this chapter.

PERFORMANCE OF GRANTS TO STATE AND LOCAL GOVERNMENTS

The Administration is committed to measuring and improving the performance of Government programs. The Congress mandated in the Government Performance and Results Act of 1993 that performance plans be developed and that the agencies report annual progress against these plans.

In addition, this Administration began in the 2004 Budget to assess every Federal program over a five year period using the Program Assessment Rating Tool, or PART. With this budget, the fourth year of using the PART, the Administration has evaluated about four-fifths of the programs of the Federal Government.

The PART assesses each program on four components (purpose, planning, management, and results/accountability) and gives a score for each of the components. The scores for each component are then weighted—results/accountability carries the greatest weight—and the program is given an overall score. A program is rated effective if it receives an overall score of 85 percent or more, Moderately Effective if the score is 70 to 84 percent, Adequate if the score is 50 to 69 percent, and Inadequate if the score is 49 percent or lower. The program is given a rating Results Not Demonstrated if the program does not have good performance measures or lacks data for existing measures. Chapter 2 of this volume discusses the PART in more detail.

As shown in Table 8–2, 211 of the programs that have been assessed are primarily grants to State and local governments. Of these 211, 86 programs, or 41 percent of all grant programs assessed, received a rating of Results Not Demonstrated. This is higher than for all programs, in which 31 percent were given this rating. The higher percent of grants that have this rating might be explained in part because of the breadth of purpose of some grants, lack of agreement among grantees and Federal parties on the purpose and performance measures, and therefore lack of focused planning to achieve common goals.

Table 8–2 also shows that the average rating for the 211 grant programs was Adequate. These programs had total spending of $209.8 billion in 2005. Of these 211 programs:

The ratings of the largest four of these 211 grant programs are summarized here. More complete summaries of these and other programs can be found at *ExpectMore.gov*.

- *Department of Transportation: Highway Infrastructure ($32.1 billion in 2005). Rating: Moderately Effective*. This program has been successful in improving highway safety and maintaining mobility—traffic-related fatalities per 100 million vehicle miles traveled have decreased from 1.51 in 2001 to an estimated 1.43 in 2005. But the program does not have adequate measures to demonstrate improved efficiency or cost effectiveness. For example, the program does not measure project cost and schedule performance. It also does not hold program managers or States accountable for cost, schedule, or performance results because oversight of State management of Federal highway dollars is lacking. The Administration is preparing a plan for improving program and project oversight of States, directing more resources to comprehensive evaluation activities (particularly at the State project level), and devising efficiency measures to show that program delivery is cost-effective.
- *Department of Housing and Urban Development (HUD): Housing Vouchers ($14.8 billion in 2005). Rating: Moderately Effective*. A variety of studies show housing vouchers to be a cost-effective means of delivering decent, safe and sanitary housing for low-income families. Housing subsidies provide access in most cases to better housing, often in better neighborhoods. The new funding structure simplifies the program and allocates tenant-based assistance on a budget, rather than unit basis, assuring that resources for housing assist-

Table 8–2. SUMMARY OF PART RATINGS AND SCORES FOR GRANTS TO STATE AND LOCAL GOVERNMENTS

Components	Average Scores	
	All grant programs (211 programs)	Programs excluding grants rated "results not demonstrated" (86 programs)
Purpose	82%	86%
Planning	60%	77%
Management	74%	80%
Results/Accountability	31%	44%
Average rating [1]	Adequate	Adequate
Rating [1]	**Number of grant programs**	**2005 Program Level (in millions)**
Effective	6	17,800
Moderately effective	41	99,444
Adequate	62	40,100
Ineffective	16	10,716
Results not demonstrated	86	41,712
Total number of grant programs rated	211	209,772

[1] Weighted as follows: Purpose (20%), Planning (10%), Management (20%), Results/Accountability (50%). The rating of effective indicates a score of 85 percent or more; moderately effective, 70–85 percent; adequate, 50–70 percent; and ineffective, 49 percent or less.

ance are fully utilized. The Administration will continue to work with Congress to streamline the program, giving more flexibility to Public Housing Agencies to administer the program to better address local needs and market conditions.

- *Department of Education: IDEA Special Education Grants to States ($10.6 billion for 2005). Rating: Adequate*. This program has made some progress in improving student achievements. Between 2000 and 2005, the percentage of students with disabilities scoring at or above Basic on the National Assessment of Educational Progress (the Nation's Report Card) grew from 22% to 33% for 4th grade reading and from 20% to 31% for 8th grade mathematics. Also, more students with disabilities are staying in school. An independent evaluation is needed to provide information on the relationship between outcomes for children with disabilities and the program. While performance on the Nation's Report Card has improved, drop-out rates have declined, and graduation rates have increased, there is little information on the program's role in relation to these outcomes.
- *Department of Agriculture: National School Lunch ($7.0 billion in 2005). Rating: Results Not Demonstrated.* This program provides funds to States for lunches served to children in schools. This program is generally well designed and has a clear purpose, however, the program does not have a reliable measure of the level of erroneous payments it makes. While the assessment was based largely on existing measures, these measures do not adequately demonstrate results. USDA is taking steps to improve the programs's performance measures.

Block Grants. One of the most common tools used by the Federal Government is the block grant, particularly in the social services area where States and localities are the service providers. Block grants are embraced for their flexibility to meet local needs and criticized because accountability for results can be difficult when funds are allocated based on formulas and population rather than achievements or needs. In addition, block grants pose performance measurement challenges precisely because they can be used for a wide range of activities. The obstacles to measuring and achieving results through block grants are reflected in PART scores: they receive the second lowest average score of the seven PART types, 8 percent of block grant programs assessed to date were rated ineffective, and 39 percent were rated "results not demonstrated."

Nonetheless, the PART shows that some Federal block grant programs are achieving results better than others, effectively combining the flexibility that localities need with the results that taxpayers deserve. In the coming year, the Administration will apply the lessons learned from the effective block grants to several of those performing inadequately. This project will identify the methods used to manage highly rated block grant programs and adapt and implement those practices in large, low-scoring programs. Each of the programs targeted for improvement will develop an action plan and implementation timeline that will be tracked quarterly. The targeted programs will be re-analyzed through the PART in one to two years to assess whether implementing the block grant "best practices" results in improved performance.

HISTORICAL PERSPECTIVES

In recent decades, Federal aid to State and local governments has become a major factor in the financing of certain government functions. The rudiments of the present system date back to the Civil War. The Morrill Act, passed in 1862, established the land grant colleges and instituted certain federally-required standards for States that received the grants, as is characteristic of the present grant programs. Federal aid was later initiated for agriculture, highways, vocational education and rehabilitation, forestry, and public health. In the depression years, Federal aid was extended to meet income security and other social welfare needs. However, Federal grants did not become a significant factor in Federal Government expenditures until after World War II.

Table 8–3 displays trends in Federal grants to State and local governments since 1960. Section A shows Federal grants by function. Functions with a substantial amount of grants are shown separately. Grants for the national defense, energy, social security, and the veterans benefits and services functions are combined in the “other functions” line in the table.

Table 8–3. TRENDS IN FEDERAL GRANTS TO STATE AND LOCAL GOVERNMENTS
(Outlays; in billions of dollars)

	Actual										Estimate	
	1960	1965	1970	1975	1980	1985	1990	1995	2000	2005	2006	2007
A. Distribution of grants by function:												
Natural resources and environment	0.1	0.2	0.4	2.4	5.4	4.1	3.7	4.0	4.6	5.9	5.8	5.9
Agriculture	0.2	0.5	0.6	0.4	0.6	2.4	1.3	0.8	0.7	0.9	0.8	0.7
Transportation	3.0	4.1	4.6	5.9	13.0	17.0	19.2	25.8	32.2	43.4	46.7	51.5
Community and regional development	0.1	0.6	1.8	2.8	6.5	5.2	5.0	7.2	8.7	20.2	22.3	21.8
Education, training, employment, and social services	0.5	1.1	6.4	12.1	21.9	17.1	21.8	30.9	36.7	57.2	60.3	57.9
Health	0.2	0.6	3.8	8.8	15.8	24.5	43.9	93.6	124.8	197.8	210.6	216.5
Income security	2.6	3.5	5.8	9.4	18.5	27.9	36.8	58.4	68.7	90.9	93.7	95.0
Administration of Justice	....	....	0.0	0.7	0.5	0.1	0.6	1.2	5.3	4.8	3.7	4.7
General government	0.2	0.2	0.5	7.1	8.6	6.8	2.3	2.3	2.1	4.4	4.4	4.1
Other	*	0.1	0.1	0.2	0.7	0.8	0.8	0.8	0.9	0.8	0.8	0.9
Total	7.0	10.9	24.1	49.8	91.4	105.9	135.3	225.0	284.7	426.2	449.3	459.0
B. Distribution of grants by BEA category:												
Discretionary	N/A	2.9	10.2	21.0	53.3	55.5	63.3	94.0	116.7	181.9	187.9	191.3
Mandatory	N/A	8.0	13.9	28.8	38.1	50.4	72.0	131.0	168.0	244.3	261.4	267.8
Total	7.0	10.9	24.1	49.8	91.4	105.9	135.3	225.0	284.7	426.2	449.3	459.0
C. Composition:												
Current dollars:												
Payments for individuals [1]	2.5	3.7	8.7	16.8	32.6	50.1	77.3	144.4	182.6	273.5	287.6	296.3
Physical capital [1]	3.3	5.0	7.1	10.9	22.6	24.9	27.2	39.6	48.7	60.8	65.9	69.9
Other grants	1.2	2.2	8.3	22.2	36.2	30.9	30.9	41.0	53.4	91.9	95.7	92.8
Total	7.0	10.9	24.1	49.8	91.4	105.9	135.3	225.0	284.7	426.2	449.3	459.0
Percentage of total grants:												
Payments for individuals [1]	35.3%	34.1%	36.2%	33.6%	35.7%	47.3%	57.1%	64.2%	64.1%	64.2%	64.0%	64.5%
Physical capital [1]	47.3%	45.7%	29.3%	21.9%	24.7%	23.5%	20.1%	17.6%	17.1%	14.3%	14.7%	15.2%
Other grants	17.4%	20.2%	34.5%	44.5%	39.6%	29.2%	22.8%	18.2%	18.8%	21.6%	21.3%	20.2%
Total	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Constant (FY 2000) dollars:												
Payments for individuals [1]	12.0	16.9	33.5	48.0	63.9	75.0	96.6	157.6	182.6	244.8	248.7	250.1
Physical capital [1]	17.0	24.2	27.2	26.0	38.9	34.2	32.6	43.3	48.7	53.7	55.5	56.8
Other grants	10.0	15.6	44.6	83.8	89.9	53.9	42.9	47.0	53.4	75.5	75.0	70.2
Total	39.0	56.7	105.3	157.7	192.6	163.1	172.1	247.9	284.7	374.0	379.2	377.1
D. Total grants as a percent of:												
Federal outlays:												
Total	7.6%	9.2%	12.3%	15.0%	15.5%	11.2%	10.8%	14.8%	15.9%	17.2%	16.6%	16.6%
Domestic programs [2]	18.0%	18.3%	23.2%	21.7%	22.2%	18.2%	17.1%	21.6%	22.0%	23.3%	22.7%	22.7%
State and local expenditures	14.8%	15.5%	20.1%	24.0%	27.4%	22.0%	18.9%	22.8%	22.1%	24.4%	N/A	N/A
Gross domestic product	1.4%	1.6%	2.4%	3.2%	3.4%	2.6%	2.4%	3.1%	2.9%	3.5%	3.4%	3.3%
E. As a share of total State and local gross investments:												
Federal capital grants	24.6%	25.5%	25.4%	26.0%	35.4%	30.2%	21.9%	26.0%	21.9%	21.2%	N/A	N/A
State and local own-source financing	75.4%	74.5%	74.6%	74.0%	64.6%	69.8%	78.1%	74.0%	78.1%	78.8%	N/A	N/A
Total	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	N/A	N/A

N/A = Not available.
* 50 million or less.
[1] Grants that are both payments for individuals and capital investment are shown under capital investment.
[2] Excludes national defense, international affairs, net interest, and undistributed offsetting receipts

Federal grants for transportation increased to $3.0 billion, or 43 percent of all Federal grants, in 1960 after initiation of aid to States to build the Interstate Highway System in the late 1950s.

By 1970 there had been significant increases in the relative amounts for education, training, employment, social services, and health (largely Medicaid).

In the early and mid-1970s, major new grants were created for natural resources and environment (construction of sewage treatment plants), community and regional development (community development block grants), and general government (general revenue sharing).

Since the late 1970s changes in the relative amounts among functions reflect steady growth of grants for health (Medicaid) and income security. The functions with the largest amount of grants are health; income security; education, training, employment, and social services; and transportation, with combined estimated grant outlays of $374.0 billion, or more than 90 percent of total grant outlays in 2005.

The increase in total outlays for grants overall since 1990 has been driven by increases in grants for health, which have increased more than four-fold from $43.9 billion in 1990 to $197.8 billion in 2005. The income security; education, training, employment, and social services; and transportation functions also increased substantially, but at a slower rate than the increase for health.

Section B of the Table shows the distribution of grants divided into mandatory and discretionary spending.

Funding required for grant programs classified as mandatory is determined in authorizing legislation. Funding levels for mandatory programs can only be changed by changing eligibility criteria or benefit formulas established in law and are usually not limited by the annual appropriations process. Outlays for mandatory grant programs were $244.3 billion in 2005. The three largest mandatory grant programs are Medicaid, with outlays of $199.3 billion in 2007, Temporary Assistance for Needy Families, $17.4 billion, and child nutrition programs, $13.2 billion.

The funding level for discretionary grant programs is determined annually through appropriations acts. Outlays for discretionary grant programs were $181.9 billion in 2005. Table 8–4 at the end of this chapter identifies discretionary and mandatory grant programs separately. For more information on the Budget Enforcement Act and these categories, see Chapter 26, "The Budget System and Concepts" in this volume.

Section C of Table 8–3 shows the composition of grants divided into three major categories: payments for individuals, grants for physical capital, and other grants.[2] Grant outlays for payments for individuals, which are mainly entitlement programs in which the Federal Government and the States share the costs, have grown significantly as a percent of total grants. They increased from 57 percent of the total in 1990 to 64 percent of the total in 2005.

These grants are distributed through State or local governments to provide cash or in-kind benefits that constitute income transfers to individuals or families. The major grant in this category is Medicaid. Temporary Assistance for Needy Families, Food Stamps administration, child nutrition programs, and housing assistance are also large grants in this category.

Grants for physical capital assist States and localities with construction and other physical capital activities. The major capital grants are for highways, but there are also grants for airports, mass transit, sewage treatment plant construction, community development, and other facilities. Grants for physical capital were almost half of total grants in 1960, shortly after grants began for construction of the Interstate Highway System. The relative share of these outlays has declined, as payments for individuals have grown. In 2005, grants for physical capital were $60.8 billion, 14 percent of total grants.

The other grants are primarily for education, training, employment, and social services. These grants were 22 percent of total grants in 2005.

Section C of Table 8–3 also shows these three categories in constant dollars. In constant 2000 dollars, total grants increased from $172.1 billion in 1990 to an estimated $374.0 billion in 2005, an average increase of 5.3 percent per year. During this same period, grants for payments to individuals increased an average of 6.4 percent per year; grants for physical capital an average of 3.4 percent per year, and other grants an average of 3.8 percent per year.

In contrast to these increases, outlays for total grants in constant 2000 dollars decreased during the 1980s, from $192.6 billion in 1980 to $172.1 billion in 1990.

Section D of this table shows grants as a percentage of Federal outlays, State and local expenditures, and gross domestic product. Grants have increased as a percentage of total Federal outlays from 11 percent in 1990 to 17 percent in 2005. Grants as a percentage of domestic programs were 23 percent in 2005. As a percentage of total State and local expenditures, grants have increased from 19 percent in 1990 to 24 percent in 2005.

Section E shows the relative contribution of physical capital grants in assisting States and localities with gross investment. Federal capital grants are estimated to be 21 percent of State and local gross investment in 2005.

OTHER INFORMATION ON FEDERAL AID TO STATE AND LOCAL GOVERNMENTS

Additional information regarding aid to State and local governments can be found elsewhere in this budget and in other documents.

Major public physical capital investment programs providing Federal grants to State and local governments are identified in Chapter 6, "Federal Investment."

Data for summary and detailed grants to State and local governments can be found in many sections of a separate budget volume entitled *Historical Tables.* Section 12 of that document is devoted exclusively to grants to State and local governments. Additional information on grants can be found in Section 6 (Composition of Federal Government Outlays); Section 9 (Federal Government Outlays for Investment: Major Physical Capital, Research and Development, and Education and Training); Section 11 (Federal Government Payments

[2] Certain housing grants are classified in the budget as both payments for individuals and physical capital spending. In the text and tables in this section, these grants are included in the category for physical capital spending.

for Individuals); and Section 15 (Total (Federal and State and Local) Government Finances).

In addition to these sources, a number of other sources of information are available that use slightly different concepts of grants, provide State-by-State information, provide information on how to apply for Federal aid, or display information about audits.

The Bureau of the Census in the Department of Commerce provides data on public finances, including Federal aid to State and local governments. The Bureau's major reports and databases on grant-making include:

Federal Aid to States, a report on Federal spending by State for grants for the most recently completed fiscal year.

The Consolidated Federal Funds Report is an annual document that shows the distribution of Federal spending by State and county areas and by local governmental jurisdictions.

The Federal Assistance Awards Data System (FAADS) provides computerized information about current grant funding. Data on all direct assistance awards are provided quarterly to the States and to the Congress.

The Federal Audit Clearinghouse maintains an online database *(http://harvester.census.gov/sac)* that provides access to summary information about audits conducted under OMB Circular A–133, "Audits to States, Local Governments, and Non-Profit Organizations." Information is available for each audited entity, including the amount of Federal money expended by program and whether there were audit findings.

The Bureau of Economic Analysis, also in the Department of Commerce, publishes the monthly *Survey of Current Business*, which provides data on the national income and product accounts (NIPA), a broad statistical concept encompassing the entire economy. These accounts include data on Federal grants to State and local governments. Data using the NIPA concepts appear in this volume in Chapter 14, "National Income and Product Accounts."

The *Catalog of Federal Domestic Assistance* is a primary reference source for communities wishing to apply for grants and other domestic assistance. The *Catalog* is prepared by the General Services Administration with data collected by the Office of Management and Budget. It contains a detailed listing of grant and other assistance programs; discussions of eligibility criteria, application procedures, and estimated obligations; and related information. The *Catalog* is available on the Internet at *http://www.cfda.gov.*

DETAILED FEDERAL AID TABLE

Table 8–4, "Federal Grants to State and Local Governments-Budget Authority and Outlays," provides detailed budget authority and outlay data for grants, including proposed legislation. This table displays discretionary and mandatory grant programs separately.

Table 8–4. FEDERAL GRANTS TO STATE AND LOCAL GOVERNMENTS—BUDGET AUTHORITY AND OUTLAYS

(in millions of dollars)

Function, Category, Agency and Program	Budget Authority			Outlays		
	2005 Actual	2006 Estimate	2007 Estimate	2005 Actual	2006 Estimate	2007 Estimate
NATIONAL DEFENSE						
Discretionary:						
Department of Defense—Military:						
Research, Development, Test, and Evaluation:						
Research, development, test, and evaluation, Army	3	2	2	2	1	1
ENERGY						
Discretionary:						
Department of Energy:						
Energy Programs:						
Energy conservation	272	......	......	271	150	41
Energy supply and conservation	......	279	213	......	125	215
Total, discretionary	**272**	**279**	**213**	**271**	**275**	**256**
Mandatory:						
Tennessee Valley Authority fund	365	375	422	365	375	422
Total, energy	**637**	**654**	**635**	**636**	**650**	**678**
NATURAL RESOURCES AND ENVIRONMENT						
Discretionary:						
Department of Agriculture:						
Farm Service Agency:						
Grassroots source water protection program	......	4	......	......	4	......
Natural Resources Conservation Service:						
Watershed rehabilitation program	4	5	2	2	2	1
Resource conservation and development	......	......	......	1	1	1
Watershed and flood prevention operations	120	105	......	61	138	100
Forest Service:						
State and private forestry	345	311	221	321	369	347
Management of national forest lands for subsistence uses	6	5	5	6	5	5
Department of Commerce:						
National Oceanic and Atmospheric Administration:						
Operations, research, and facilities	108	90	90	57	43	42
Pacific coastal salmon recovery	88	67	67	77	80	81
Procurement, acquisition and construction	110	104	14	110	104	14
Department of the Interior:						
Office of Surface Mining Reclamation and Enforcement:						
Regulation and technology	58	59	60	57	58	59
Abandoned mine reclamation fund	168	167	167	185	166	163
Bureau of Reclamation:						
Bureau of Reclamation loan subsidy	21	2	......	21	2	......
United States Fish and Wildlife Service:						
State and tribal wildlife grants	69	67	75	61	64	73
Cooperative endangered species conservation fund	81	81	80	56	81	80
Landowner incentive program	22	22	25	10	14	18
National Park Service:						
Urban park and recreation fund	......	......	......	17	16	10
National recreation and preservation	61	54	33	60	56	41
Land acquisition and State assistance	91	29	1	80	78	75
Historic preservation fund	72	72	72	64	74	74
Environmental Protection Agency:						
State and tribal assistance grants	3,575	3,148	2,797	3,583	3,569	3,511
Hazardous substance superfund	119	59	42	92	57	114
Leaking underground storage tank trust fund	59	68	60	59	65	56
Total, discretionary	**5,177**	**4,519**	**3,811**	**4,980**	**5,046**	**4,865**
Mandatory:						
Department of the Interior:						
Bureau of Land Management:						
Miscellaneous permanent payment accounts	250	157	154	250	159	154
Minerals Management Service:						
National forests fund, Payment to States	8	8	7	8	8	7
Leases of lands acquired for flood control, navigation, and allied purposes	5	3	3	5	3	3

Table 8–4. FEDERAL GRANTS TO STATE AND LOCAL GOVERNMENTS—BUDGET AUTHORITY AND OUTLAYS—Continued

(in millions of dollars)

Function, Category, Agency and Program	Budget Authority			Outlays		
	2005 Actual	2006 Estimate	2007 Estimate	2005 Actual	2006 Estimate	2007 Estimate
Coastal impact assistance	....	....	250	....	....	250
United States Fish and Wildlife Service:						
Federal aid in wildlife restoration	251	264	277	243	239	244
Cooperative endangered species conservation fund	35	39	43	35	39	43
Sport fish restoration	339	364	424	331	346	374
Departmental Management:						
Everglades restoration account	....	....	....	1	1	....
Department of the Treasury:						
Financial Management Service:						
Payment to terrestrial wildlife habitat restoration trust fund	5	5	5	5	5	5
Total, mandatory	**893**	**840**	**1,163**	**878**	**800**	**1,080**
Total, natural resources and environment	**6,070**	**5,359**	**4,974**	**5,858**	**5,846**	**5,945**
AGRICULTURE						
Discretionary:						
Department of Agriculture:						
Cooperative State Research, Education, and Extension Service:						
Extension activities	451	456	436	440	452	437
Outreach for socially disadvantaged farmers	6	6	7	5	6	7
Research and education activities	243	241	237	241	240	240
Integrated activities	26	25	7	23	24	22
Agricultural Marketing Service:						
Payments to States and possessions	10	11	1	7	3	8
Farm Service Agency:						
State mediation grants	4	4	4	4	4	4
Total, discretionary	**740**	**743**	**692**	**720**	**729**	**718**
Mandatory:						
Department of Agriculture:						
Office of the Secretary:						
Fund for rural America	....	....	....	4	1	....
Farm Service Agency:						
Commodity Credit Corporation fund	209	69	29	209	69	29
Total, mandatory	**209**	**69**	**29**	**213**	**70**	**29**
Total, agriculture	**949**	**812**	**721**	**933**	**799**	**747**
COMMERCE AND HOUSING CREDIT						
Mandatory:						
Department of Commerce:						
National Oceanic and Atmospheric Administration:						
Promote and develop fishery products and research pertaining to American fisheries	13	12	2	23	12	2
National Telecommunications and Information Administration:						
Digital television transition and public safety fund	....	....	15	....	....	15
Total, commerce and housing credit	**13**	**12**	**17**	**23**	**12**	**17**
TRANSPORTATION						
Discretionary:						
Department of Transportation:						
Federal Aviation Administration:						
Grants-in-aid for airports (Airport and airway trust fund)	....	....	....	3,530	3,800	3,705
Federal Highway Administration:						
Emergency relief program	....	2,750	....	....	743	1,128
State infrastructure banks	....	....	....	1	1	1
Appalachian development highway system	80	20	....	113	145	130
Federal-aid highways	....	....	....	30,915	32,639	36,481
Miscellaneous appropriations	–2	....	....	208	195	147
Miscellaneous highway trust funds	34	....	....	230	196	180
Federal Motor Carrier Safety Administration:						
National motor carrier safety program	168	....	....	....	....	....
Motor carrier safety	73	....	....	....	73	....

Table 8–4. FEDERAL GRANTS TO STATE AND LOCAL GOVERNMENTS—BUDGET AUTHORITY AND OUTLAYS—Continued

(in millions of dollars)

Function, Category, Agency and Program	Budget Authority			Outlays		
	2005 Actual	2006 Estimate	2007 Estimate	2005 Actual	2006 Estimate	2007 Estimate
Motor Carrier Safety Grants	....	279	298	....	78	285
National Highway Traffic Safety Administration:						
Highway traffic safety grants	211	556	566	205	371	497
Federal Railroad Administration:						
Alaska railroad rehabilitation	25	10	....	35	21	6
Federal Transit Administration:						
Job access and reverse commute grants	125	....	....	99	121	95
Interstate transfer grants-transit	....	....	....	1	....	....
Washington Metropolitan Area Transit Authority	....	....	....	....	3	2
Formula grants	4,871	85	....	4,521	3,453	2,416
Capital investment grants	3,363	1,487	1,466	3,374	3,803	3,233
Research and university research centers	11	....	....	....	....	....
Discretionary grants (Highway trust fund, mass transit account)	....	....	....	119	90	67
Formula and bus grants	....	6,910	7,263	....	958	3,119
Pipeline and Hazardous Materials Safety Administration:						
Pipeline safety	19	20	21	19	20	23
United States-Canada Alaska Rail Commission:						
Contribution to United States-Canada Alaska Rail Commission	....	....	....	2	2	....
Total, discretionary	**8,978**	**12,117**	**9,614**	**43,372**	**46,712**	**51,515**
Mandatory:						
Department of Transportation:						
Federal Aviation Administration:						
Grants-in-aid for airports (Airport and airway trust fund)	3,696	3,070	2,725	....	....	....
Federal Highway Administration:						
Federal-aid highways	38,121	35,100	41,423	....	....	....
Right-of-way revolving fund liquidating account	–2	–11	....	–2	–11	....
Total, mandatory	**41,815**	**38,159**	**44,148**	**–2**	**–11**	....
Total, transportation	**50,793**	**50,276**	**53,762**	**43,370**	**46,701**	**51,515**
COMMUNITY AND REGIONAL DEVELOPMENT						
Discretionary:						
Department of Agriculture:						
Rural Development:						
Rural community advancement program	726	632	529	814	704	714
Rural Utilities Service:						
Distance learning, telemedicine, and broadband program	16	16	11	14	14	10
Department of Commerce:						
Economic Development Administration:						
Economic development assistance programs	256	250	297	332	361	339
Department of Homeland Security:						
Preparedness:						
State and local programs	2,775	2,315	2,457	2,116	1,407	2,097
Firefighter assistance grants	715	648	293	1,185	278	547
Federal Emergency Management Agency:						
Operating Expenses	....	....	....	132	222	3
Mitigation grants	....	....	....	39	66	20
Disaster Relief	58,163	–21,920	1,650	10,069	11,831	10,718
Department of Housing and Urban Development:						
Community Planning and Development:						
Community development fund	4,852	15,678	2,676	4,985	6,906	6,787
Urban development action grants	....	....	....	2	2	2
Community development loan guarantees subsidy	7	4	....	4	5	5
Brownfields redevelopment	24	....	....	12	12	11
Empowerment zones/enterprise communities/renewal communities	10	....	....	48	45	43
Office of Lead Hazard Control and Healthy Homes:						
Lead hazard reduction	167	150	115	133	139	150
Department of the Interior:						
Bureau of Indian Affairs:						
Operation of Indian programs	146	144	150	150	146	146
Indian guaranteed loan subsidy	9	26	6	7	26	7
Appalachian Regional Commission	58	57	59	65	71	75
Delta regional authority	4	12	4	9	12	8

Table 8–4. FEDERAL GRANTS TO STATE AND LOCAL GOVERNMENTS—BUDGET AUTHORITY AND OUTLAYS—Continued

(in millions of dollars)

Function, Category, Agency and Program	Budget Authority			Outlays		
	2005 Actual	2006 Estimate	2007 Estimate	2005 Actual	2006 Estimate	2007 Estimate
Denali Commission	67	50	3	49	49	84
Total, discretionary	**67,995**	**–1,938**	**8,250**	**20,165**	**22,296**	**21,766**
Mandatory:						
Department of Housing and Urban Development:						
Community Planning and Development:						
Community development loan guarantees subsidy	2	3	....	2	3	....
Total, community and regional development	**67,997**	**–1,935**	**8,250**	**20,167**	**22,299**	**21,766**
EDUCATION, TRAINING, EMPLOYMENT, AND SOCIAL SERVICES						
Discretionary:						
Department of Commerce:						
National Telecommunications and Information Administration:						
Public telecommunications facilities, planning and construction	22	20	....	24	34	25
Information infrastructure grants	....	....	....	21	14	8
Department of Education:						
Office of Elementary and Secondary Education:						
Reading excellence	....	....	....	40	19	....
Indian education	115	115	115	117	119	114
Impact aid	1,236	1,224	1,224	1,249	1,339	1,224
Chicago litigation settlement	....	....	....	1	....	....
Education reform	....	....	....	32	58	....
Education for the disadvantaged	14,797	14,434	16,423	14,539	14,812	15,653
School improvement programs	5,469	5,110	4,831	6,569	5,808	5,200
Office of Innovation and Improvement:						
Innovation and improvement	550	648	688	230	731	665
Office of Safe and Drug-Free Schools:						
Safe schools and citizenship education	821	692	250	363	800	757
Office of English Language Acquisition:						
English language acquisition	617	629	629	582	732	575
Office of Special Education and Rehabilitative Services:						
Special education	11,466	11,439	10,709	10,661	10,416	11,312
Rehabilitation services and disability research	135	127	90	146	186	104
American Printing House for the Blind	17	18	18	17	22	18
Office of Vocational and Adult Education:						
Vocational and adult education	1,974	1,967	1,355	1,930	2,003	1,903
Office of Postsecondary Education:						
Higher education	414	403	....	436	502	418
Office of Federal Student Aid:						
Student financial assistance	66	65	....	60	74	52
Institute of Education Sciences:						
Institute of education sciences	25	25	55	11	19	27
Hurricane Education Recovery:						
Hurricane education recovery	....	1,600	....	....	1,460	140
Department of Health and Human Services:						
Administration for Children and Families:						
Promoting safe and stable families	394	446	446	399	406	434
Children and families services programs	8,685	8,566	7,879	8,490	8,514	8,175
Administration on Aging:						
Aging services programs	1,370	1,345	1,318	1,379	1,337	1,328
Department of the Interior:						
Bureau of Indian Affairs:						
Operation of Indian programs	116	116	116	117	111	111
Department of Labor:						
Employment and Training Administration:						
Training and employment services	3,509	3,125	3,770	3,372	3,077	3,180
Community service employment for older Americans	97	94	388	97	97	388
State unemployment insurance and employment service operations	141	123	25	137	146	112
Unemployment trust fund	1,061	961	232	469	989	232
Corporation for National and Community Service:						
Domestic volunteer service programs, operating expenses	116	105	105	109	142	115
National and community service programs, operating expenses	271	277	258	235	271	375
Corporation for Public Broadcasting:						
Corporation for Public Broadcasting	466	460	347	466	460	347

Table 8–4. FEDERAL GRANTS TO STATE AND LOCAL GOVERNMENTS—BUDGET AUTHORITY AND OUTLAYS—Continued

(in millions of dollars)

Function, Category, Agency and Program	Budget Authority			Outlays		
	2005 Actual	2006 Estimate	2007 Estimate	2005 Actual	2006 Estimate	2007 Estimate
District of Columbia:						
District of Columbia General and Special Payments:						
Federal payment for resident tuition support	26	33	35	26	33	35
Federal payment for school improvement	40	40	41	40	40	41
National Endowment for the Arts: grants and administration	40	40	40	37	39	41
Institute of Museum and Library Services:						
Office of Museum and Library Services: grants and administration	269	238	249	239	314	279
Total, discretionary	**54,325**	**54,485**	**51,636**	**52,640**	**55,124**	**53,388**
Mandatory:						
Department of Education:						
Office of Special Education and Rehabilitative Services:						
Rehabilitation services and disability research	2,636	2,720	2,837	2,535	2,730	2,797
Department of Health and Human Services:						
Administration for Children and Families:						
Social services block grant	1,700	2,250	1,200	1,822	2,224	1,402
Department of Labor:						
Employment and Training Administration:						
Welfare to work jobs	....	....	....	6	....	....
Federal unemployment benefits and allowances	259	259	260	244	259	260
Foreign labor certification processing	....	....	3	....	....	3
Total, mandatory	**4,595**	**5,229**	**4,300**	**4,607**	**5,213**	**4,462**
Total, education, training, employment, and social services	**58,920**	**59,714**	**55,936**	**57,247**	**60,337**	**57,850**
HEALTH						
Discretionary:						
Department of Agriculture:						
Food Safety and Inspection Service:						
Salaries and expenses	44	44	45	38	43	45
Department of Health and Human Services:						
Health Resources and Services Administration:						
Health resources and services	3,888	3,332	3,843	3,227	3,707	3,772
Centers for Disease Control and Prevention:						
Disease control, research, and training	2,733	4,040	4,107	2,782	3,331	4,049
Substance Abuse and Mental Health Services Administration:						
Substance abuse and mental health services	2,338	2,315	2,266	3,203	2,326	2,302
Departmental Management:						
Public health and social services emergency fund	1,535	583	8	1,451	398	6
General departmental management	109	122	114	105	85	86
Department of Labor:						
Occupational Safety and Health Administration:						
Salaries and expenses	101	101	91	101	101	101
Mine Safety and Health Administration:						
Salaries and expenses	8	8	8	8	8	8
Total, discretionary	**10,756**	**10,545**	**10,482**	**10,915**	**9,999**	**10,369**
Mandatory:						
Department of Health and Human Services:						
Centers for Medicare and Medicaid Services:						
Grants to States for medicaid	177,540	215,471	200,698	181,720	192,334	199,287
State children's health insurance fund	4,082	4,365	5,040	5,129	5,775	5,948
State grants and demonstrations	536	2,527	1,309	84	2,472	847
Total, mandatory	**182,158**	**222,363**	**207,047**	**186,933**	**200,581**	**206,082**
Total, health	**192,914**	**232,908**	**217,529**	**197,848**	**210,580**	**216,451**
INCOME SECURITY						
Discretionary:						
Department of Agriculture:						
Food and Nutrition Service:						
Commodity assistance program	178	189	71	177	182	82

Table 8–4. FEDERAL GRANTS TO STATE AND LOCAL GOVERNMENTS—BUDGET AUTHORITY AND OUTLAYS—Continued

(in millions of dollars)

Function, Category, Agency and Program	Budget Authority			Outlays		
	2005 Actual	2006 Estimate	2007 Estimate	2005 Actual	2006 Estimate	2007 Estimate
Special supplemental nutrition program for women, infants, and children (WIC)	5,235	5,173	5,200	4,985	5,198	5,200
Department of Health and Human Services:						
Administration for Children and Families:						
Low income home energy assistance	2,182	2,161	1,782	2,095	2,170	1,867
Refugee and entrant assistance	301	387	432	419	449	497
Payments to States for the child care and development block grant	2,076	2,055	2,055	2,110	2,034	2,056
Department of Homeland Security:						
Federal Emergency Management Agency:						
Emergency food and shelter	153	151	151	153	151	151
Department of Housing and Urban Development:						
Public and Indian Housing Programs:						
Public housing operating fund	2,437	3,564	3,564	3,572	3,545	3,564
Drug elimination grants for low-income housing	–21			6	6	2
Revitalization of severely distressed public housing (HOPE VI)	143	99	–99	695	651	594
Native Hawaiian Housing Block Grant		9	6		1	3
Tenant based rental assistance	10,600	15,808	15,920	10,031	15,434	16,024
Project-based rental assistance	848	806	908	345	782	852
Public housing capital fund	2,579	2,439	2,178	3,153	3,112	2,865
Prevention of resident displacement				–79	79	
Native American housing block grant	601	624	626	684	716	702
Housing certificate fund	2,169	–2,050	–2,000	7,280	2,439	2,163
Community Planning and Development:						
Homeless assistance grants	1,230	1,327	1,536	1,282	1,332	1,388
Home investment partnership program	1,900	1,757	1,917	1,718	1,774	1,822
Housing opportunities for persons with AIDS	282	286	300	280	284	289
Rural housing and economic development	24	17		24	23	22
Housing Programs:						
Homeownership and opportunity for people everywhere grants (HOPE grants)	–3			3	3	3
Housing for persons with disabilities	238	237	119	307	258	260
Housing for the elderly	741	735	546	902	875	875
Department of Labor:						
Employment and Training Administration:						
Unemployment trust fund	2,674	2,558	2,650	3,198	2,608	2,679
Total, discretionary	**36,567**	**38,332**	**37,862**	**43,340**	**44,106**	**43,960**
Mandatory:						
Department of Agriculture:						
Agricultural Marketing Service:						
Funds for strengthening markets, income, and supply (section 32)	722	1,130	1,187	826	1,416	887
Food and Nutrition Service:						
Food stamp program	4,452	4,590	4,738	4,385	4,561	4,718
Commodity assistance program	15	15	15	15	15	15
Child nutrition programs	11,752	12,533	13,489	11,726	12,717	13,156
Department of Health and Human Services:						
Administration for Children and Families:						
Payments to States for child support enforcement and family support programs	4,074	3,322	3,960	3,982	3,903	4,112
Low income home energy assistance			1,000			771
Contingency fund	1,958		232	43	131	105
Payments to States for foster care and adoption assistance	6,806	6,708	6,973	6,427	6,603	6,906
Child care entitlement to States	3,708	1,926	2,917	2,784	2,868	2,909
Temporary assistance for needy families	22,348	11,988	17,158	17,357	17,406	17,471
Total, mandatory	**55,835**	**42,212**	**51,669**	**47,545**	**49,620**	**51,050**
Total, income security	**92,402**	**80,544**	**89,531**	**90,885**	**93,726**	**95,010**
SOCIAL SECURITY						
Mandatory:						
Social Security Administration:						
Federal disability insurance trust fund	12	64	54	2	38	59

Table 8–4. FEDERAL GRANTS TO STATE AND LOCAL GOVERNMENTS—BUDGET AUTHORITY AND OUTLAYS—Continued

(in millions of dollars)

Function, Category, Agency and Program	Budget Authority			Outlays		
	2005 Actual	2006 Estimate	2007 Estimate	2005 Actual	2006 Estimate	2007 Estimate
VETERANS BENEFITS AND SERVICES						
Discretionary:						
Department of Veterans Affairs:						
Construction:						
Grants for construction of State extended care facilities	104	85	85	97	92	92
Grants for the construction of State veterans cemeteries	32	32	32	21	23	27
Total, veterans benefits and services	**136**	**117**	**117**	**118**	**115**	**119**
ADMINISTRATION OF JUSTICE						
Discretionary:						
Department of Health and Human Services:						
Administration for Children and Families:						
Violent crime reduction programs				1		
Department of Homeland Security:						
Preparedness:						
State and local programs	495	400		221	223	272
Department of Housing and Urban Development:						
Fair Housing and Equal Opportunity:						
Fair housing activities	46	46	45	47	46	46
Department of Justice:						
Legal Activities and U.S. Marshals:						
Assets forfeiture fund	21	21	21	23	21	21
Office of Justice Programs:						
Justice assistance	145	119	770	284	60	1,048
State and local law enforcement assistance	1,163	1,094		1,523	905	1,120
Juvenile justice programs	325	268		343	204	354
Community oriented policing services	499	386	–26	931	667	336
Violence against women prevention and prosecution programs	370	368	333	233	502	491
Crime victims fund		–19			–11	–6
Equal Employment Opportunity Commission:						
Salaries and expenses	33	31	28	30	24	43
Federal Drug Control Programs:						
High-intensity drug trafficking areas program	196	225		187	170	
State Justice Institute: salaries and expenses	3	4		2	5	
Total, discretionary	**3,296**	**2,943**	**1,171**	**3,825**	**2,816**	**3,725**
Mandatory:						
Department of Justice:						
Legal Activities and U.S. Marshals:						
Assets forfeiture fund	313	263	300	306	258	270
Office of Justice Programs:						
Crime victims fund	589	569	589	572	587	648
Department of the Treasury:						
Departmental Offices:						
Treasury forfeiture fund	81	75	75	81	75	75
Total, mandatory	**983**	**907**	**964**	**959**	**920**	**993**
Total, administration of justice	**4,279**	**3,850**	**2,135**	**4,784**	**3,736**	**4,718**
GENERAL GOVERNMENT						
Discretionary:						
Department of Health and Human Services:						
Administration for Children and Families:						
Disabled voter services				2	5	5
Department of the Interior:						
United States Fish and Wildlife Service:						
National wildlife refuge fund	14	14	11	14	14	13
Departmental Management:						
Payments in lieu of taxes	227	233	198	227	235	200
Insular Affairs:						
Assistance to territories	48	49	47	54	58	61
Trust Territory of the Pacific Islands				3	1	1

Table 8–4. FEDERAL GRANTS TO STATE AND LOCAL GOVERNMENTS—BUDGET AUTHORITY AND OUTLAYS—Continued

(in millions of dollars)

Function, Category, Agency and Program	Budget Authority			Outlays		
	2005 Actual	2006 Estimate	2007 Estimate	2005 Actual	2006 Estimate	2007 Estimate
District of Columbia:						
District of Columbia Courts:						
Federal payment to the District of Columbia courts	189	217	197	159	214	199
Defender services in District of Columbia courts	38	45	43	37	45	43
District of Columbia General and Special Payments:						
Federal support for economic development and management reforms in the District	69	52	58	70	52	58
Election Assistance Commission:						
Election reform programs	....	....	....	980	67	....
Total, discretionary	**585**	**610**	**554**	**1,546**	**691**	**580**
Mandatory:						
Department of Agriculture:						
Forest Service:						
Forest Service permanent appropriations	438	421	491	403	469	491
Department of Energy:						
Energy Programs:						
Payments to States under Federal Power Act	3	3	3	3	3	3
Department of Homeland Security:						
Security, Enforcement, and Investigations:						
Refunds, transfers, and expenses of operation, Puerto Rico	100	98	98	89	138	98
Department of the Interior:						
Bureau of Land Management:						
Miscellaneous permanent payment accounts	106	109	100	106	104	100
Minerals Management Service:						
Mineral leasing and associated payments	1,621	2,397	2,221	1,621	2,397	2,221
Geothermal lease revenues, payment to counties	....	3	....	....	3	....
United States Fish and Wildlife Service:						
National wildlife refuge fund	12	6	7	7	10	6
Insular Affairs:						
Assistance to territories	28	28	28	22	29	28
Payments to the United States territories, fiscal assistance	145	144	144	143	143	143
Department of the Treasury:						
Alcohol and Tobacco Tax and Trade Bureau:						
Internal revenue collections for Puerto Rico	421	441	457	421	441	457
Corps of Engineers-Civil Works:						
Permanent appropriations	9	9	9	9	9	9
Total, mandatory	**2,883**	**3,659**	**3,558**	**2,824**	**3,746**	**3,556**
Total, general government	**3,468**	**4,269**	**4,112**	**4,370**	**4,437**	**4,136**
Total, Grants	**478,593**	**436,646**	**437,775**	**426,243**	**449,277**	**459,012**
Discretionary	188,830	122,754	124,404	181,894	187,910	191,262
Mandatory	289,763	313,892	313,371	244,349	261,367	267,750

APPENDIX: SELECTED GRANT DATA BY STATE

This Appendix displays State-by-State spending for the selected grant programs to State and local governments shown in the following table, "Summary of Programs by Agency and Bureau." The programs selected here cover more than 80 percent of total grant spending.

The first summary table shows the obligations for each program. The second summary table, "Summary of Programs by State," shows the amounts for each State for these programs. The individual program tables display obligations for each program on a State-by-State basis, consistent with the estimates in this budget. Each table reports the following information:

- The Federal agency that administers the program.
- The program title and number as contained in the *Catalog of Federal Domestic Assistance.*
- The budget account number from which the program is funded.
- Actual 2005 obligations by State, Federal territory, and Indian tribes in thousands of dollars. Undistributed obligations shown at the bottom of each page are generally project funds that are not

distributed by formula, or programs for which State-by-State data are not available.

- Estimates of 2006 obligations by State from previous budget authority, from new budget authority, and total obligations.
- Estimates of 2007 obligations by State, which are also based on the 2007 budget request, unless otherwise noted.
- The percentage share of 2007 estimated program funds distributed to each State.

Table 8–5. SUMMARY OF PROGRAMS BY AGENCY, BUREAU, AND PROGRAM

(obligations in millions of dollars)

Agency, Bureau, and Program	FY 2005 (actual)	Estimated FY 2006 obligations from:			FY 2007 (estimated)
		Previous authority	New authority	Total	
Department of Agriculture, Food and Nutrition Service					
National School Lunch Program (10.555)	7,038	36	7,421	7,458	7,832
Special Supplemental Nutrition Program for Women, Infants, and Children (WIC) (10.557)	5,193	194	5,205	5,399	5,361
Child and Adult Care Food Program (10.558)	2,134	....	2,156	2,156	2,272
State Administrative Matching Grants for Food Stamp Program (10.561)	2,388	....	2,510	2,510	2,608
Department of Education, Office of Elementary and Secondary Education					
Title I Grants to Local Educational Agencies (84.010)	12,740	....	12,713	12,713	12,713
Improving Teacher Quality State Grants (84.367)	2,917	....	2,887	2,887	2,887
Department of Education, Office of Special Education and Rehabilitative Services					
Special Education—Grants to States (84.027)	10,590	....	10,583	10,583	10,683
Rehabilitation Services—Vocational Rehabilitation Grants to States (84.126)	2,636	....	2,720	2,720	2,837
Department of Health and Human Services, Centers for Medicare and Medicaid Services					
State Children's Health Insurance Program (93.767)	4,082	....	4,365	4,365	5,040
Grants to States for Medicaid (93.778)	193,198	....	215,564	215,564	201,829
Department of Health and Human Services, Administration for Children and Families					
Temporary Assistance for Needy Families (TANF)—Family Assistance Grants (93.558a)	17,284	....	17,191	17,191	17,271
Child Support Enforcement—Federal Share of State and Local Administrative Costs and Incentives (93.563)	4,083	....	4,069	4,069	4,071
Low Income Home Energy Assistance Program (93.568a)	1,885	....	1,980	1,980	2,032
Child Care and Development Block Grant (93.575)	2,083	....	2,062	2,062	2,062
Child Care and Development Fund—Mandatory (93.596a)	1,235	....	1,240	1,240	1,240
Child Care and Development Fund—Matching (93.596b)	1,491	....	1,677	1,677	1,677
Head Start (93.600)	6,842	....	6,876	6,876	6,786
Foster Care—Title IV–E (93.658)	4,371	....	4,633	4,633	4,786
Adoption Assistance (93.659)	1,712	....	1,883	1,883	2,047
Department of Homeland Security, Departmental Management					
Homeland Security Grant Program (97.067)	2,519	....	413	413	276
Department of Housing and Urban Development, Public and Indian Housing Programs					
Public Housing Operating Fund (14.850)	2,440	1	3,564	3,565	3,564
Housing Choice Vouchers (14.871)	13,856	85	15,808	15,893	15,840
Public Housing Capital Fund (14.872)	2,555	322	2,117	2,439	2,178
Department of Housing and Urban Development, Community Planning and Development					
Community Development Block Grants (14.218, 14.219, 14.228)	4,702	....	4,178	4,178	3,032
HOME Investment Partnerships Program (14.239)	1,900	....	1,757	1,757	1,917
Department of Transportation, Federal Aviation Administration					
Airport Improvement Program (20.106)	3,673	*	3,514	3,515	2,750
Department of Transportation, Federal Highway Administration					
Highway Planning and Construction (20.205)	33,189	....	37,946	37,946	39,922
Department of Transportation, Federal Transit Administration					
Capital Investment Grants—Fixed Guideway Modernization (Section 5309) (20.500)	1,033	233	1,111	1,344	1,730
Federal Transit Formula Grants and Research (Section 5307) (20.507)	4,692	1,353	3,543	4,897	6,150
Total	354,461	2,224	381,688	383,912	373,392

* $500,000 or less

Table 8–6. Summary of Programs by State

(obligations in millions of dollars)

State or Territory	All programs FY 2005 (actual)	Programs distributed in all years					FY 2007 Percentage of distributed total
		FY 2005 (actual)	Estimated FY 2006 obligations from:			FY 2007 (estimated)	
			Previous authority	New authority	Total		
Alabama	5,220	5,220	31	5,205	5,236	5,383	1.47
Alaska	1,634	1,634	4	1,747	1,751	1,849	0.50
Arizona	6,617	6,617	40	7,116	7,156	7,631	2.08
Arkansas	3,818	3,818	8	3,768	3,776	4,016	1.10
California	43,965	43,965	273	42,195	42,467	43,293	11.82
Colorado	3,375	3,375	9	3,456	3,464	3,572	0.97
Connecticut	4,064	4,064	72	4,230	4,302	4,368	1.19
Delaware	910	910	6	945	951	985	0.27
District of Columbia	1,910	1,910	22	1,765	1,787	1,934	0.53
Florida	16,266	16,266	81	16,095	16,176	17,041	4.65
Georgia	9,014	9,014	63	8,945	9,008	9,355	2.55
Hawaii	1,387	1,387	5	1,409	1,415	1,422	0.39
Idaho	1,465	1,465	3	1,536	1,540	1,729	0.47
Illinois	12,902	12,902	86	12,612	12,699	13,205	3.60
Indiana	6,476	6,476	27	6,886	6,913	7,318	2.00
Iowa	2,951	2,951	7	3,049	3,056	3,119	0.85
Kansas	2,561	2,561	10	2,653	2,663	2,755	0.75
Kentucky	5,251	5,251	14	5,541	5,555	5,647	1.54
Louisiana	6,600	6,600	28	6,868	6,897	6,949	1.90
Maine	2,197	2,197	6	2,120	2,125	2,245	0.61
Maryland	5,163	5,163	52	5,285	5,337	5,537	1.51
Massachusetts	8,589	8,589	103	8,788	8,892	8,217	2.24
Michigan	10,355	10,355	27	10,051	10,078	10,210	2.79
Minnesota	5,493	5,493	52	5,102	5,154	5,783	1.58
Mississippi	4,532	4,532	13	4,733	4,746	4,876	1.33
Missouri	7,045	7,045	23	7,000	7,023	7,581	2.07
Montana	1,263	1,263	4	1,265	1,269	1,289	0.35
Nebraska	1,893	1,893	5	1,923	1,927	1,994	0.54
Nevada	1,652	1,652	22	1,692	1,714	1,759	0.48
New Hampshire	1,243	1,243	9	1,244	1,253	1,271	0.35
New Jersey	8,694	8,694	50	9,036	9,086	9,509	2.60
New Mexico	3,018	3,018	10	3,061	3,070	3,142	0.86
New York	38,313	38,313	527	40,079	40,606	41,817	11.41
North Carolina	9,657	9,657	47	10,238	10,285	10,800	2.95
North Dakota	935	935	3	906	908	921	0.25
Ohio	13,734	13,734	53	13,959	14,011	14,301	3.90
Oklahoma	4,047	4,047	11	4,185	4,197	4,424	1.21
Oregon	3,682	3,682	11	3,734	3,745	3,767	1.03
Pennsylvania	15,561	15,561	58	16,266	16,324	16,846	4.60
Rhode Island	1,697	1,697	9	1,743	1,752	1,790	0.49
South Carolina	4,918	4,918	22	4,821	4,843	4,972	1.36
South Dakota	1,010	1,010	4	1,097	1,101	1,097	0.30
Tennessee	8,086	8,086	30	7,859	7,890	8,114	2.21
Texas	22,347	22,347	116	22,884	23,000	23,782	6.49
Utah	2,107	2,107	5	2,139	2,144	2,252	0.61
Vermont	1,019	1,019	2	1,051	1,053	1,080	0.29
Virginia	5,269	5,269	34	5,462	5,495	5,744	1.57
Washington	6,213	6,213	32	6,200	6,232	6,414	1.75
West Virginia	2,960	2,960	5	2,856	2,861	3,045	0.83
Wisconsin	5,547	5,547	22	5,396	5,418	5,600	1.53
Wyoming	675	675	1	696	697	713	0.19
American Samoa	131	131	*	63	64	61	0.02
Guam	129	129	1	135	135	135	0.04
Northern Mariana Islands	72	72	*	67	67	58	0.02
Puerto Rico	2,269	2,269	64	2,352	2,417	2,455	0.67
Freely Associated States	7	7	....	7	7	8	*
Virgin Islands	139	139	1	149	150	149	0.04
Indian Tribes	942	942	2	1,046	1,048	1,079	0.29
Total, programs distributed by State in all years	**348,989**	**348,989**	**2,224**	**352,709**	**354,933**	**366,411**	**100.00**
MEMORANDUM:.							
Not distributed by State in all years [1]	5,472	5,472	*	28,979	28,979	6,982	N/A
Total, including undistributed	354,461	354,461	2,224	381,688	383,912	373,392	N/A

* $500,000 or less or 0.005 percent or less.
[1] The sum of programs not distributed by State in all years.

Table 8–7. National School Lunch Program (10.555)

(obligations in thousands of dollars)

State or Territory	FY 2005 Actual	Estimated FY 2006 obligations from:			FY 2007 (estimated)	FY 2007 Percentage of distributed total
		Previous authority	New authority	Total		
Alabama	134,787	699	142,629	143,328	150,530	1.92
Alaska	19,883	103	21,040	21,143	22,205	0.28
Arizona	155,099	804	164,123	164,927	173,215	2.21
Arkansas	82,294	427	87,082	87,509	91,906	1.17
California	938,538	4,866	993,142	998,008	1,048,162	13.38
Colorado	69,284	359	73,315	73,674	77,376	0.99
Connecticut	57,336	297	60,672	60,969	64,033	0.82
Delaware	15,349	80	16,242	16,322	17,142	0.22
District of Columbia	15,133	78	16,013	16,091	16,901	0.22
Florida	415,135	2,152	439,288	441,440	463,624	5.92
Georgia	281,878	1,461	298,278	299,739	314,802	4.02
Hawaii	27,974	145	29,602	29,747	31,241	0.40
Idaho	32,429	168	34,316	34,484	36,217	0.46
Illinois	275,770	1,429	291,815	293,244	307,980	3.93
Indiana	125,964	653	133,293	133,946	140,677	1.80
Iowa	58,528	303	61,933	62,236	65,364	0.83
Kansas	59,847	310	63,329	63,639	66,837	0.85
Kentucky	116,788	605	123,583	124,188	130,429	1.67
Louisiana	154,746	802	163,749	164,551	172,821	2.21
Maine	21,083	109	22,310	22,419	23,546	0.30
Maryland	90,348	468	95,605	96,073	100,901	1.29
Massachusetts	96,675	501	102,300	102,801	107,967	1.38
Michigan	179,314	929	189,747	190,676	200,258	2.56
Minnesota	88,925	461	94,099	94,560	99,312	1.27
Mississippi	112,324	582	118,859	119,441	125,444	1.60
Missouri	129,621	672	137,163	137,835	144,761	1.85
Montana	16,183	84	17,125	17,209	18,073	0.23
Nebraska	38,145	198	40,364	40,562	42,600	0.54
Nevada	44,884	233	47,495	47,728	50,127	0.64
New Hampshire	14,267	74	15,097	15,171	15,933	0.20
New Jersey	139,282	722	147,386	148,108	155,550	1.99
New Mexico	61,754	320	65,347	65,667	68,967	0.88
New York	456,276	2,365	482,823	485,188	509,570	6.51
North Carolina	207,768	1,077	219,856	220,933	232,036	2.96
North Dakota	11,706	61	12,387	12,448	13,073	0.17
Ohio	203,843	1,057	215,703	216,760	227,652	2.91
Oklahoma	99,840	518	105,649	106,167	111,501	1.42
Oregon	68,891	357	72,899	73,256	76,938	0.98
Pennsylvania	213,753	1,108	226,190	227,298	238,720	3.05
Rhode Island	20,067	104	21,235	21,339	22,411	0.29
South Carolina	124,966	648	132,237	132,885	139,562	1.78
South Dakota	18,128	94	19,183	19,277	20,245	0.26
Tennessee	150,573	780	159,334	160,114	168,160	2.15
Texas	784,132	4,064	829,754	833,818	875,720	11.18
Utah	55,301	287	58,519	58,806	61,760	0.79
Vermont	9,249	48	9,787	9,835	10,329	0.13
Virginia	133,381	691	141,141	141,832	148,960	1.90
Washington	115,403	598	122,117	122,715	128,882	1.65
West Virginia	44,807	232	47,414	47,646	50,041	0.64
Wisconsin	93,623	485	99,070	99,555	104,558	1.33
Wyoming	9,080	47	9,608	9,655	10,141	0.13
American Samoa	....	....	....	....	....	....
Guam	4,753	25	5,030	5,055	5,308	0.07
Northern Mariana Islands	....	....	....	....	....	....
Puerto Rico	108,322	561	114,624	115,185	120,974	1.54
Freely Associated States	....	....	....	....	....	....
Virgin Islands	4,353	23	4,606	4,629	4,861	0.06
Indian Tribes	....	....	....	....	....	....
Undistributed	24,558	....	....	....	....	....
DOD/AF/USMC/Navy	5,399	28	5,713	5,741	6,030	0.08
Total	**7,037,739**	**36,352**	**7,421,220**	**7,457,572**	**7,832,333**	[1] **100.00**

[1] Excludes undistributed obligations.

Table 8–8. Special Supplemental Nutrition Program for Women, Infants, and Children (WIC) (10.557)

(obligations in thousands of dollars)

State or Territory	FY 2005 Actual	Estimated FY 2006 obligations from:			FY 2007 (estimated)	FY 2007 Percentage of distributed total
		Previous authority	New authority	Total		
Alabama	84,542	3,176	84,470	87,646	87,347	1.64
Alaska	22,447	843	22,428	23,271	23,192	0.43
Arizona	100,062	3,759	99,977	103,736	103,382	1.94
Arkansas	56,952	2,140	56,904	59,044	58,841	1.10
California	876,412	32,928	875,666	908,594	905,484	16.98
Colorado	52,566	1,975	52,521	54,496	54,310	1.02
Connecticut	36,301	1,364	36,270	37,634	37,505	0.70
Delaware	11,498	432	11,488	11,920	11,879	0.22
District of Columbia	14,575	548	14,563	15,111	15,059	0.28
Florida	242,460	9,109	242,254	251,363	250,504	4.70
Georgia	159,952	6,009	159,816	165,825	165,259	3.10
Hawaii	29,954	1,125	29,929	31,054	30,948	0.58
Idaho	21,450	806	21,432	22,238	22,162	0.42
Illinois	185,439	6,967	185,281	192,248	191,591	3.59
Indiana	78,351	2,944	78,284	81,228	80,950	1.52
Iowa	41,404	1,556	41,369	42,925	42,778	0.80
Kansas	38,280	1,438	38,247	39,685	39,550	0.74
Kentucky	78,227	2,939	78,161	81,100	80,822	1.52
Louisiana	106,994	4,020	106,903	110,923	110,544	2.07
Maine	12,290	462	12,280	12,742	12,698	0.24
Maryland	61,538	2,312	61,486	63,798	63,580	1.19
Massachusetts	69,304	2,604	69,245	71,849	71,603	1.34
Michigan	136,164	5,116	136,048	141,164	140,681	2.64
Minnesota	73,038	2,744	72,976	75,720	75,461	1.42
Mississippi	66,548	2,500	66,491	68,991	68,756	1.29
Missouri	76,108	2,859	76,043	78,902	78,633	1.47
Montana	14,414	542	14,402	14,944	14,892	0.28
Nebraska	24,614	925	24,593	25,518	25,431	0.48
Nevada	28,694	1,078	28,670	29,748	29,646	0.56
New Hampshire	10,257	385	10,248	10,633	10,597	0.20
New Jersey	94,715	3,558	94,635	98,193	97,857	1.84
New Mexico	37,911	1,424	37,879	39,303	39,169	0.73
New York	348,973	13,111	348,677	361,788	360,550	6.76
North Carolina	144,750	5,438	144,627	150,065	149,552	2.80
North Dakota	9,647	362	9,639	10,001	9,967	0.19
Ohio	161,697	6,075	161,560	167,635	167,061	3.13
Oklahoma	52,953	1,989	52,908	54,897	54,710	1.03
Oregon	64,981	2,441	64,926	67,367	67,137	1.26
Pennsylvania	141,328	5,310	141,208	146,518	146,017	2.74
Rhode Island	14,669	551	14,657	15,208	15,156	0.28
South Carolina	67,680	2,543	67,623	70,166	69,925	1.31
South Dakota	12,844	483	12,833	13,316	13,270	0.25
Tennessee	104,841	3,939	104,752	108,691	108,319	2.03
Texas	496,564	18,656	496,142	514,798	513,038	9.62
Utah	35,336	1,328	35,306	36,634	36,508	0.68
Vermont	11,657	438	11,647	12,085	12,044	0.23
Virginia	81,775	3,072	81,706	84,778	84,488	1.58
Washington	112,217	4,216	112,122	116,338	115,940	2.17
West Virginia	33,175	1,246	33,147	34,393	34,276	0.64
Wisconsin	67,796	2,547	67,738	70,285	70,045	1.31
Wyoming	6,686	251	6,680	6,931	6,908	0.13
American Samoa	6,381	240	6,376	6,616	6,593	0.12
Guam	6,622	249	6,616	6,865	6,842	0.13
Northern Mariana Islands	....	....	....	....	....	....
Puerto Rico	179,575	6,747	179,422	186,169	185,533	3.48
Freely Associated States	....	....	....	....	....	....
Virgin Islands	5,324	200	5,319	5,519	5,501	0.10
Indian Tribes	49,692	1,867	49,650	51,517	51,341	0.96
Undistributed	31,906	....	48,510	48,510	29,000	....
Total	[1] **5,192,530**	**193,886**	**5,204,750**	**5,398,636**	**5,360,832**	[2] **100.00**

[1] Excludes $10 million in FY 2005 for Farmers' Market; beginning in FY 2005 the Farmers' Market Program is funded in the Commodity Assistance Program.
[2] Excludes undistributed obligations.

Table 8–9. Child and Adult Care Food Program (10.558)

(obligations in thousands of dollars)

State or Territory	FY 2005 Actual	Estimated FY 2006 obligations from:			FY 2007 (estimated)	FY 2007 Percentage of distributed total
		Previous authority	New authority	Total		
Alabama	33,102	....	36,802	36,802	38,775	1.71
Alaska	7,283	....	8,097	8,097	8,531	0.38
Arizona	44,097	....	49,026	49,026	51,654	2.27
Arkansas	26,405	....	29,356	29,356	30,930	1.36
California	241,325	....	268,303	268,303	282,684	12.44
Colorado	19,804	....	22,018	22,018	23,198	1.02
Connecticut	10,033	....	11,154	11,154	11,752	0.52
Delaware	9,230	....	10,262	10,262	10,812	0.48
District of Columbia	3,323	....	3,694	3,694	3,892	0.17
Florida	107,809	....	119,859	119,859	126,285	5.56
Georgia	76,915	....	85,512	85,512	90,097	3.97
Hawaii	49	....	54	54	57	*
Idaho	4,787	....	5,322	5,322	5,607	0.25
Illinois	4,705	....	5,231	5,231	5,511	0.24
Indiana	29,152	....	32,410	32,410	34,148	1.50
Iowa	19,733	....	21,939	21,939	23,115	1.02
Kansas	29,864	....	33,202	33,202	34,982	1.54
Kentucky	25,027	....	27,824	27,824	29,316	1.29
Louisiana	52,130	....	57,957	57,957	61,064	2.69
Maine	9,177	....	10,203	10,203	10,750	0.47
Maryland	33,573	....	37,326	37,326	39,327	1.73
Massachusetts	43,140	....	47,962	47,962	50,533	2.22
Michigan	50,280	....	55,900	55,900	58,897	2.59
Minnesota	55,451	....	61,649	61,649	64,954	2.86
Mississippi	25,064	....	27,866	27,866	29,359	1.29
Missouri	36,786	....	40,898	40,898	43,090	1.90
Montana	8,817	....	9,803	9,803	10,328	0.45
Nebraska	22,813	....	25,363	25,363	26,723	1.18
Nevada	3,833	....	4,261	4,261	4,490	0.20
New Hampshire	2,723	....	3,027	3,027	3,190	0.14
New Jersey	47,865	....	53,215	53,215	56,068	2.47
New Mexico	35,637	....	39,620	39,620	41,744	1.84
New York	146,616	....	163,004	163,004	171,743	7.56
North Carolina	73,753	....	81,997	81,997	86,393	3.80
North Dakota	8,870	....	9,861	9,861	10,390	0.46
Ohio	57,555	....	63,988	63,988	67,419	2.97
Oklahoma	48,912	....	54,379	54,379	57,294	2.52
Oregon	22,405	....	24,909	24,909	26,245	1.16
Pennsylvania	52,857	....	58,765	58,765	61,916	2.73
Rhode Island	6,424	....	7,142	7,142	7,525	0.33
South Carolina	22,937	....	25,501	25,501	26,868	1.18
South Dakota	6,311	....	7,016	7,016	7,393	0.33
Tennessee	39,729	....	44,170	44,170	46,538	2.05
Texas	168,742	....	187,603	187,603	197,661	8.70
Utah	19,537	....	21,721	21,721	22,885	1.01
Vermont	3,931	....	4,370	4,370	4,605	0.20
Virginia	28,329	....	31,495	31,495	33,184	1.46
Washington	37,743	....	41,962	41,962	44,211	1.95
West Virginia	14,926	....	16,594	16,594	17,484	0.77
Wisconsin	34,149	....	37,966	37,966	40,001	1.76
Wyoming	4,744	....	5,274	5,274	5,557	0.24
American Samoa	....	....	....	....	....	....
Guam	49	....	54	54	57	*
Northern Mariana Islands	....	....	....	....	....	....
Puerto Rico	20,565	....	22,864	22,864	24,089	1.06
Freely Associated States	....	....	....	....	....	....
Virgin Islands	625	....	695	695	732	0.03
Indian Tribes	....	....	....	....	....	....
Undistributed	194,777	....	....	....	....	....
Total	**2,134,418**	....	**2,156,445**	**2,156,445**	**2,272,053**	[1] **100.00**

* $500 or less or 0.005 percent or less.
[1] Excludes undistributed obligations.

Table 8–10. State Administrative Matching Grants for Food Stamp Program (10.561)

(obligations in thousands of dollars)

State or Territory	FY 2005 Actual	Estimated FY 2006 obligations from: Previous authority	New authority	Total	FY 2007 (estimated)	FY 2007 Percentage of distributed total
Alabama	27,878	....	30,025	30,025	31,198	1.20
Alaska	8,564	....	9,224	9,224	9,584	0.37
Arizona	34,648	....	37,317	37,317	38,774	1.49
Arkansas	23,592	....	25,409	25,409	26,401	1.01
California	352,407	....	379,554	379,554	394,372	15.12
Colorado	21,499	....	23,156	23,156	24,060	0.92
Connecticut	19,341	....	20,831	20,831	21,644	0.83
Delaware	8,324	....	8,965	8,965	9,315	0.36
District of Columbia	11,552	....	12,442	12,442	12,928	0.50
Florida	70,735	....	76,184	76,184	79,158	3.04
Georgia	56,833	....	61,211	61,211	63,601	2.44
Hawaii	9,528	....	10,262	10,262	10,663	0.41
Idaho	7,942	....	8,554	8,554	8,888	0.34
Illinois	83,271	....	89,685	89,685	93,187	3.57
Indiana	37,716	....	40,622	40,622	42,208	1.62
Iowa	15,347	....	16,530	16,530	17,175	0.66
Kansas	14,194	....	15,287	15,287	15,884	0.61
Kentucky	29,436	....	31,703	31,703	32,941	1.26
Louisiana	45,856	....	49,388	49,388	51,317	1.97
Maine	10,295	....	11,088	11,088	11,521	0.44
Maryland	33,498	....	36,079	36,079	37,487	1.44
Massachusetts	33,562	....	36,148	36,148	37,559	1.44
Michigan	89,828	....	96,748	96,748	100,525	3.85
Minnesota	37,933	....	40,855	40,855	42,450	1.63
Mississippi	24,805	....	26,716	26,716	27,759	1.06
Missouri	35,676	....	38,425	38,425	39,925	1.53
Montana	7,200	....	7,755	7,755	8,058	0.31
Nebraska	15,135	....	16,300	16,300	16,937	0.65
Nevada	11,852	....	12,765	12,765	13,264	0.51
New Hampshire	4,674	....	5,034	5,034	5,230	0.20
New Jersey	87,679	....	94,433	94,433	98,120	3.76
New Mexico	19,858	....	21,388	21,388	22,223	0.85
New York	254,629	....	274,244	274,244	284,951	10.93
North Carolina	60,586	....	65,254	65,254	67,801	2.60
North Dakota	5,293	....	5,701	5,701	5,924	0.23
Ohio	97,553	....	105,067	105,067	109,170	4.19
Oklahoma	36,592	....	39,411	39,411	40,950	1.57
Oregon	40,663	....	43,796	43,796	45,506	1.74
Pennsylvania	133,381	....	143,655	143,655	149,264	5.72
Rhode Island	6,924	....	7,457	7,457	7,748	0.30
South Carolina	19,667	....	21,182	21,182	22,009	0.84
South Dakota	6,756	....	7,276	7,276	7,561	0.29
Tennessee	37,475	....	40,361	40,361	41,937	1.61
Texas	144,477	....	155,606	155,606	161,682	6.20
Utah	19,759	....	21,281	21,281	22,112	0.85
Vermont	5,866	....	6,318	6,318	6,564	0.25
Virginia	71,864	....	77,400	77,400	80,422	3.08
Washington	43,307	....	46,644	46,644	48,465	1.86
West Virginia	12,743	....	13,725	13,725	14,261	0.55
Wisconsin	31,532	....	33,961	33,961	35,287	1.35
Wyoming	4,015	....	4,324	4,324	4,493	0.17
American Samoa	....	....	....	....	....	....
Guam	2,611	....	2,812	2,812	2,922	0.11
Northern Mariana Islands	....	....	....	....	....	....
Puerto Rico	....	....	....	....	....	....
Freely Associated States	....	....	....	....	....	....
Virgin Islands	4,124	....	4,442	4,442	4,615	0.18
Indian Tribes	....	....	....	....	....	....
Undistributed	57,744	....	....	....	....	....
Total	**2,388,219**	....	**2,510,000**	**2,510,000**	**2,608,000**	[1] **100.00**

[1] Excludes undistributed obligations.

Table 8–11. Title I Grants to Local Educational Agencies (84.010)

(obligations in thousands of dollars)

State or Territory	FY 2005 Actual	Estimated FY 2006 obligations from:			FY 2007 (estimated)	FY 2007 Percentage of distributed total
		Previous authority	New authority	Total		
Alabama	195,054	....	198,408	198,408	198,102	1.56
Alaska	33,685	....	33,200	33,200	33,200	0.26
Arizona	248,947	....	260,093	260,093	259,834	2.05
Arkansas	124,833	....	125,330	125,330	124,804	0.98
California	1,776,543	....	1,727,346	1,727,346	1,722,351	13.56
Colorado	123,503	....	128,605	128,605	127,708	1.01
Connecticut	107,511	....	100,236	100,236	97,875	0.77
Delaware	33,822	....	33,787	33,787	33,787	0.27
District of Columbia	50,359	....	48,488	48,488	48,836	0.38
Florida	607,927	....	646,510	646,510	650,547	5.12
Georgia	406,582	....	409,989	409,989	410,329	3.23
Hawaii	47,544	....	46,395	46,395	46,619	0.37
Idaho	42,239	....	42,326	42,326	42,278	0.33
Illinois	538,323	....	540,737	540,737	540,925	4.26
Indiana	174,454	....	184,162	184,162	183,611	1.45
Iowa	64,155	....	64,828	64,828	63,922	0.50
Kansas	80,552	....	81,847	81,847	80,974	0.64
Kentucky	187,313	....	185,138	185,138	184,508	1.45
Louisiana	277,695	....	283,517	283,517	281,330	2.21
Maine	48,565	....	45,582	45,582	45,026	0.35
Maryland	170,957	....	172,568	172,568	172,966	1.36
Massachusetts	230,007	....	207,508	207,508	198,938	1.57
Michigan	433,983	....	426,977	426,977	422,648	3.33
Minnesota	108,585	....	108,433	108,433	106,334	0.84
Mississippi	167,139	....	169,980	169,980	167,476	1.32
Missouri	196,404	....	188,574	188,574	186,345	1.47
Montana	41,675	....	41,016	41,016	40,421	0.32
Nebraska	51,488	....	50,553	50,553	50,158	0.39
Nevada	69,528	....	75,587	75,587	76,167	0.60
New Hampshire	32,329	....	31,019	31,019	31,019	0.24
New Jersey	271,634	....	263,753	263,753	259,882	2.05
New Mexico	109,532	....	112,238	112,238	112,158	0.88
New York	1,226,676	....	1,212,980	1,212,980	1,214,244	9.56
North Carolina	287,644	....	290,669	290,669	291,990	2.30
North Dakota	32,197	....	30,085	30,085	30,085	0.24
Ohio	386,302	....	410,139	410,139	410,668	3.23
Oklahoma	140,102	....	140,391	140,391	139,547	1.10
Oregon	124,395	....	129,583	129,583	129,689	1.02
Pennsylvania	477,867	....	483,636	483,636	482,903	3.80
Rhode Island	47,969	....	47,125	47,125	47,359	0.37
South Carolina	177,393	....	176,983	176,983	177,572	1.40
South Dakota	36,186	....	36,401	36,401	36,401	0.29
Tennessee	202,693	....	205,355	205,355	206,815	1.63
Texas	1,176,358	....	1,182,231	1,182,231	1,175,444	9.25
Utah	55,472	....	54,315	54,315	54,297	0.43
Vermont	29,138	....	28,341	28,341	28,341	0.22
Virginia	216,518	....	208,467	208,467	207,331	1.63
Washington	177,055	....	176,438	176,438	175,468	1.38
West Virginia	103,626	....	99,697	99,697	99,807	0.79
Wisconsin	161,967	....	154,835	154,835	152,418	1.20
Wyoming	29,849	....	29,417	29,417	29,417	0.23
American Samoa	8,462	....	8,494	8,494	8,506	0.07
Guam	7,546	....	10,290	10,290	10,305	0.08
Northern Mariana Islands	3,660	....	3,477	3,477	3,303	0.03
Puerto Rico	466,497	....	450,773	450,773	491,718	3.87
Freely Associated States	....	....	....	....	....	....
Virgin Islands	11,371	....	11,413	11,413	11,430	0.09
Indian Tribes	91,322	....	88,423	88,423	88,553	0.70
Undistributed	8,436	....	8,437	8,437	8,437	....
Total	**12,739,571**	....	**12,713,125**	**12,713,125**	**12,713,125**	[1] **100.00**

[1] Excludes undistributed obligations.

Table 8–12. Improving Teacher Quality State Grants (84.367)

(obligations in thousands of dollars)

State or Territory	FY 2005 Actual	Estimated FY 2006 obligations from:			FY 2007 (estimated)	FY 2007 Percentage of distributed total
		Previous authority	New authority	Total		
Alabama	46,517	....	46,132	46,132	46,132	1.61
Alaska	13,895	....	13,752	13,752	13,752	0.48
Arizona	48,398	....	48,188	48,188	48,188	1.68
Arkansas	28,501	....	28,192	28,192	28,192	0.98
California	339,448	....	335,691	335,691	335,691	11.68
Colorado	32,606	....	32,304	32,304	32,304	1.12
Connecticut	26,675	....	26,178	26,178	26,178	0.91
Delaware	13,895	....	13,752	13,752	13,752	0.48
District of Columbia	13,895	....	13,752	13,752	13,752	0.48
Florida	134,548	....	134,570	134,570	134,570	4.68
Georgia	77,412	....	77,180	77,180	77,180	2.69
Hawaii	13,895	....	13,752	13,752	13,752	0.48
Idaho	13,895	....	13,752	13,752	13,752	0.48
Illinois	117,385	....	116,337	116,337	116,337	4.05
Indiana	48,235	....	47,979	47,979	47,979	1.67
Iowa	21,805	....	21,619	21,619	21,619	0.75
Kansas	22,378	....	22,209	22,209	22,209	0.77
Kentucky	44,720	....	44,216	44,216	44,216	1.54
Louisiana	65,092	....	64,342	64,342	64,342	2.24
Maine	13,895	....	13,752	13,752	13,752	0.48
Maryland	41,626	....	41,268	41,268	41,268	1.44
Massachusetts	51,823	....	50,523	50,523	50,523	1.76
Michigan	109,399	....	108,474	108,474	108,474	3.78
Minnesota	37,961	....	37,553	37,553	37,553	1.31
Mississippi	42,379	....	41,914	41,914	41,914	1.46
Missouri	49,753	....	49,109	49,109	49,109	1.71
Montana	13,895	....	13,752	13,752	13,752	0.48
Nebraska	14,172	....	14,029	14,029	14,029	0.49
Nevada	15,155	....	15,213	15,213	15,213	0.53
New Hampshire	13,895	....	13,752	13,752	13,752	0.48
New Jersey	65,255	....	64,447	64,447	64,447	2.24
New Mexico	23,280	....	23,009	23,009	23,009	0.80
New York	230,522	....	228,758	228,758	228,758	7.96
North Carolina	65,338	....	64,879	64,879	64,879	2.26
North Dakota	13,895	....	13,752	13,752	13,752	0.48
Ohio	103,930	....	103,550	103,550	103,550	3.60
Oklahoma	33,660	....	33,337	33,337	33,337	1.16
Oregon	28,216	....	28,263	28,263	28,263	0.98
Pennsylvania	114,170	....	112,903	112,903	112,903	3.93
Rhode Island	13,895	....	13,752	13,752	13,752	0.48
South Carolina	37,140	....	36,820	36,820	36,820	1.28
South Dakota	13,895	....	13,752	13,752	13,752	0.48
Tennessee	49,645	....	49,207	49,207	49,207	1.71
Texas	241,231	....	239,610	239,610	239,610	8.34
Utah	18,732	....	18,489	18,489	18,489	0.64
Vermont	13,895	....	13,752	13,752	13,752	0.48
Virginia	52,737	....	51,696	51,696	51,696	1.80
Washington	47,513	....	47,063	47,063	47,063	1.64
West Virginia	23,784	....	23,523	23,523	23,523	0.82
Wisconsin	45,630	....	44,998	44,998	44,998	1.57
Wyoming	13,895	....	13,752	13,752	13,752	0.48
American Samoa	3,456	....	3,416	3,416	3,416	0.12
Guam	5,105	....	5,057	5,057	5,057	0.18
Northern Mariana Islands	1,628	....	1,611	1,611	1,611	0.06
Puerto Rico	95,590	....	91,729	91,729	91,729	3.19
Freely Associated States	....	....	....	....	....	....
Virgin Islands	4,322	....	4,281	4,281	4,281	0.15
Indian Tribes	14,510	....	14,365	14,365	14,365	0.50
Undistributed	14,583	....	14,437	14,437	14,437	....
Total	**2,916,605**	....	**2,887,439**	**2,887,439**	**2,887,439**	[1] **100.00**

[1] Excludes undistributed obligations.

Table 8–13. Special Education—Grants to States (84.027)

(obligations in thousands of dollars)

State or Territory	FY 2005 Actual	Estimated FY 2006 obligations from:			FY 2007 (estimated)	FY 2007 Percentage of distributed total
		Previous authority	New authority	Total		
Alabama	167,865	....	167,635	167,635	169,060	1.59
Alaska	32,499	....	32,452	32,452	33,245	0.31
Arizona	162,563	....	162,328	162,328	164,291	1.54
Arkansas	103,546	....	103,400	103,400	104,280	0.98
California	1,132,573	....	1,130,940	1,130,940	1,140,558	10.70
Colorado	137,681	....	137,481	137,481	138,651	1.30
Connecticut	122,729	....	122,567	122,567	123,609	1.16
Delaware	29,785	....	29,742	29,742	30,469	0.29
District of Columbia	14,976	....	14,954	14,954	15,320	0.14
Florida	581,254	....	580,457	580,457	585,393	5.49
Georgia	285,784	....	285,369	285,369	287,796	2.70
Hawaii	36,854	....	36,801	36,801	37,114	0.35
Idaho	50,109	....	50,036	50,036	50,462	0.47
Illinois	467,485	....	466,850	466,850	470,820	4.42
Indiana	236,054	....	235,740	235,740	237,745	2.23
Iowa	112,690	....	112,542	112,542	113,499	1.06
Kansas	98,645	....	98,509	98,509	99,347	0.93
Kentucky	145,703	....	145,505	145,505	146,743	1.38
Louisiana	174,760	....	174,506	174,506	175,990	1.65
Maine	50,509	....	50,442	50,442	50,871	0.48
Maryland	184,824	....	184,574	184,574	186,143	1.75
Massachusetts	262,025	....	261,681	261,681	263,906	2.47
Michigan	369,788	....	369,262	369,262	372,402	3.49
Minnesota	175,222	....	174,985	174,985	176,473	1.66
Mississippi	109,859	....	109,703	109,703	110,635	1.04
Missouri	209,676	....	209,400	209,400	211,180	1.98
Montana	33,928	....	33,879	33,879	34,238	0.32
Nebraska	68,924	....	68,834	68,834	69,419	0.65
Nevada	61,135	....	61,046	61,046	61,566	0.58
New Hampshire	43,805	....	43,748	43,748	44,120	0.41
New Jersey	333,645	....	333,206	333,206	336,040	3.15
New Mexico	84,127	....	84,016	84,016	84,730	0.79
New York	700,725	....	699,789	699,789	705,740	6.62
North Carolina	288,837	....	288,431	288,431	290,884	2.73
North Dakota	24,185	....	24,150	24,150	24,740	0.23
Ohio	404,055	....	403,485	403,485	406,916	3.82
Oklahoma	136,539	....	136,350	136,350	137,510	1.29
Oregon	119,052	....	118,887	118,887	119,898	1.12
Pennsylvania	394,307	....	393,753	393,753	397,102	3.72
Rhode Island	40,365	....	40,312	40,312	40,655	0.38
South Carolina	161,682	....	161,465	161,465	162,838	1.53
South Dakota	28,811	....	28,769	28,769	29,472	0.28
Tennessee	215,277	....	214,982	214,982	216,811	2.03
Texas	889,556	....	888,269	888,269	895,823	8.40
Utah	98,468	....	98,327	98,327	99,163	0.93
Vermont	23,319	....	23,285	23,285	23,854	0.22
Virginia	259,999	....	259,641	259,641	261,849	2.46
Washington	204,329	....	204,037	204,037	205,772	1.93
West Virginia	70,101	....	70,009	70,009	70,604	0.66
Wisconsin	192,169	....	191,909	191,909	193,541	1.82
Wyoming	24,464	....	24,428	24,428	25,026	0.23
American Samoa	6,125	....	6,122	6,122	6,180	0.06
Guam	13,580	....	13,575	13,575	13,704	0.13
Northern Mariana Islands	4,654	....	4,652	4,652	4,696	0.04
Puerto Rico	99,371	....	99,227	99,227	101,653	0.95
Freely Associated States	6,579	....	6,579	6,579	6,579	0.06
Virgin Islands	8,631	....	8,628	8,628	8,710	0.08
Indian Tribes	83,546	....	86,306	86,306	87,122	0.82
Undistributed	10,000	....	15,000	15,000	20,000	....
Total	**10,589,746**	....	**10,582,961**	**10,582,961**	**10,682,961**	[1] **100.00**

[1] Excludes undistributed obligations.

Table 8–14. Rehabilitation Services—Vocational Rehabilitation Grants to States (84.126)

(obligations in thousands of dollars)

State or Territory	FY 2005 Actual	Estimated FY 2006 obligations from: Previous authority	New authority	Total	FY 2007 (estimated)	FY 2007 Percentage of distributed total
Alabama	55,446	....	54,409	54,409	56,445	1.99
Alaska	8,679	....	8,957	8,957	9,342	0.33
Arizona	40,862	....	52,642	52,642	56,407	1.99
Arkansas	33,730	....	34,285	34,285	35,708	1.26
California	248,655	....	259,966	259,966	271,453	9.57
Colorado	28,244	....	32,548	32,548	34,105	1.20
Connecticut	18,830	....	19,238	19,238	19,871	0.70
Delaware	8,679	....	8,957	8,957	9,342	0.33
District of Columbia	11,990	....	11,898	11,898	12,182	0.43
Florida	139,316	....	145,570	145,570	154,109	5.43
Georgia	77,939	....	81,909	81,909	86,685	3.06
Hawaii	10,447	....	10,749	10,749	11,255	0.40
Idaho	14,210	....	14,602	14,602	15,465	0.55
Illinois	95,138	....	100,013	100,013	103,911	3.66
Indiana	61,488	....	63,749	63,749	66,226	2.33
Iowa	29,620	....	30,428	30,428	31,581	1.11
Kansas	25,388	....	25,966	25,966	26,963	0.95
Kentucky	48,288	....	49,003	49,003	50,877	1.79
Louisiana	56,120	....	54,442	54,442	56,315	1.98
Maine	14,505	....	14,385	14,385	14,885	0.52
Maryland	37,913	....	37,563	37,563	39,069	1.38
Massachusetts	43,585	....	43,959	43,959	45,164	1.59
Michigan	89,235	....	91,954	91,954	95,240	3.36
Minnesota	40,308	....	41,739	41,739	43,338	1.53
Mississippi	46,410	....	39,560	39,560	41,031	1.45
Missouri	56,855	....	58,690	58,690	61,039	2.15
Montana	10,436	....	10,456	10,456	10,907	0.38
Nebraska	16,502	....	16,870	16,870	17,540	0.62
Nevada	13,581	....	16,595	16,595	17,844	0.63
New Hampshire	9,803	....	10,173	10,173	10,574	0.37
New Jersey	52,365	....	52,405	52,405	54,175	1.91
New Mexico	21,645	....	21,362	21,362	22,360	0.79
New York	135,944	....	141,341	141,341	146,134	5.15
North Carolina	82,554	....	86,186	86,186	90,329	3.18
North Dakota	8,679	....	8,957	8,957	9,342	0.33
Ohio	111,587	....	114,494	114,494	118,397	4.17
Oklahoma	39,104	....	39,002	39,002	40,565	1.43
Oregon	31,884	....	33,265	33,265	34,855	1.23
Pennsylvania	115,158	....	117,718	117,718	121,735	4.29
Rhode Island	9,895	....	9,972	9,972	10,276	0.36
South Carolina	44,867	....	47,450	47,450	49,595	1.75
South Dakota	8,679	....	8,957	8,957	9,342	0.33
Tennessee	60,699	....	62,257	62,257	64,866	2.29
Texas	196,031	....	201,770	201,770	212,142	7.48
Utah	24,527	....	25,154	25,154	26,821	0.95
Vermont	8,679	....	8,957	8,957	9,342	0.33
Virginia	58,599	....	59,719	59,719	62,457	2.20
Washington	44,933	....	46,564	46,564	48,831	1.72
West Virginia	24,172	....	24,014	24,014	24,796	0.87
Wisconsin	52,012	....	52,854	52,854	54,832	1.93
Wyoming	7,567	....	8,957	8,957	9,342	0.33
American Samoa	66,280	....	891	891	924	0.03
Guam	868	....	2,704	2,704	2,831	0.10
Northern Mariana Islands	1,000	....	1,055	1,055	1,126	0.04
Puerto Rico	2,052	....	67,984	67,984	70,460	2.48
Freely Associated States	....	....	....	....	....	....
Virgin Islands	1,861	....	1,903	1,903	1,965	0.07
Indian Tribes	32,000	....	33,024	33,024	34,444	1.21
Undistributed	....	....	....	....	....	....
Total	**2,635,845**	....	**2,720,192**	**2,720,192**	**2,837,160**	[1] **100.00**

[1] Excludes undistributed obligations.

Table 8–15. State Children's Health Insurance Program (93.767)

(obligations in thousands of dollars)

State or Territory	FY 2005 Actual	Estimated FY 2006 obligations from:			FY 2007 (estimated)	FY 2007 Percentage of distributed total
		Previous authority	New authority	Total		
Alabama	68,041	....	64,182	64,182	79,239	1.57
Alaska	9,020	....	9,100	9,100	11,235	0.22
Arizona	106,473	....	107,366	107,366	132,554	2.63
Arkansas	48,662	....	43,796	43,796	53,961	1.07
California	667,444	....	646,682	646,682	798,393	15.84
Colorado	57,951	....	57,951	57,951	71,545	1.42
Connecticut	36,561	....	34,535	34,535	42,636	0.85
Delaware	9,046	....	9,045	9,045	11,167	0.22
District of Columbia	9,635	....	9,557	9,557	11,799	0.23
Florida	249,247	....	249,330	249,330	307,822	6.11
Georgia	130,915	....	129,458	129,458	159,828	3.17
Hawaii	12,404	....	12,404	12,404	15,314	0.30
Idaho	20,748	....	20,611	20,611	25,446	0.50
Illinois	164,936	....	169,198	169,198	208,892	4.14
Indiana	73,422	....	73,000	73,000	90,126	1.79
Iowa	28,266	....	26,987	26,987	33,318	0.66
Kansas	28,479	....	27,490	27,490	33,939	0.67
Kentucky	54,061	....	57,764	57,764	71,316	1.42
Louisiana	77,478	....	77,133	77,133	95,228	1.89
Maine	12,462	....	11,928	11,928	14,727	0.29
Maryland	48,349	....	48,708	48,708	60,135	1.19
Massachusetts	59,401	....	59,401	59,401	73,335	1.46
Michigan	111,346	....	117,165	117,165	144,652	2.87
Minnesota	38,615	....	39,377	39,377	48,613	0.96
Mississippi	48,165	....	49,916	49,916	61,626	1.22
Missouri	53,958	....	56,290	56,290	69,495	1.38
Montana	12,284	....	12,558	12,558	15,504	0.31
Nebraska	17,096	....	16,848	16,848	20,800	0.41
Nevada	40,387	....	41,896	41,896	51,729	1.03
New Hampshire	9,273	....	9,193	9,193	11,349	0.23
New Jersey	84,735	....	89,476	89,476	110,467	2.19
New Mexico	42,157	....	42,157	42,157	52,045	1.03
New York	270,142	....	272,452	272,452	336,369	6.67
North Carolina	110,255	....	110,255	110,255	136,117	2.70
North Dakota	6,385	....	6,346	6,346	7,835	0.16
Ohio	125,842	....	124,632	124,632	153,871	3.05
Oklahoma	57,371	....	57,371	57,371	70,828	1.41
Oregon	47,255	....	46,887	46,887	57,886	1.15
Pennsylvania	130,964	....	134,097	134,097	165,556	3.28
Rhode Island	9,355	....	9,781	9,781	12,076	0.24
South Carolina	54,306	....	55,545	55,545	68,576	1.36
South Dakota	7,887	....	7,828	7,828	9,665	0.19
Tennessee	78,905	....	80,407	80,407	99,270	1.97
Texas	449,972	....	454,742	454,742	561,423	11.14
Utah	31,699	....	32,208	32,208	39,764	0.79
Vermont	4,903	....	4,818	4,818	5,948	0.12
Virginia	76,255	....	72,303	72,303	89,265	1.77
Washington	64,705	....	64,706	64,706	79,883	1.58
West Virginia	24,423	....	23,350	23,350	28,827	0.57
Wisconsin	51,870	....	55,764	55,764	68,846	1.37
Wyoming	6,364	....	5,881	5,881	7,261	0.14
American Samoa	510	....	510	510	630	0.01
Guam	1,488	....	1,488	1,488	1,837	0.04
Northern Mariana Islands	468	....	468	468	577	0.01
Puerto Rico	38,953	....	38,953	38,953	48,090	0.95
Freely Associated States	....	....	....	....	....	....
Virgin Islands	1,106	....	1,106	1,106	1,365	0.03
Indian Tribes	....	....	....	....	....	....
Undistributed	....	....	....	....	....	....
Adjustments	....	....	283,000	283,000	....	....
Total	**4,082,400**	....	**4,365,400**	**4,365,400**	**5,040,000**	[1] **100.00**

[1] Excludes undistributed obligations.

Table 8–16. Grants to States for Medicaid (93.778)

(obligations in thousands of dollars)

State or Territory	FY 2005 Actual	Estimated FY 2006 obligations from: Previous authority	New authority	Total	FY 2007 (estimated)	FY 2007 Percentage of distributed total
Alabama	2,843,720	....	2,814,065	2,814,065	2,958,233	1.47
Alaska	681,336	....	751,683	751,683	847,012	0.42
Arizona	4,092,137	....	4,535,708	4,535,708	4,954,401	2.45
Arkansas	2,436,921	....	2,316,051	2,316,051	2,521,112	1.25
California	22,102,201	....	20,444,000	20,444,000	20,619,586	10.22
Colorado	1,516,864	....	1,565,218	1,565,218	1,616,666	0.80
Connecticut	2,127,062	....	2,224,219	2,224,219	2,260,633	1.12
Delaware	483,462	....	489,958	489,958	513,632	0.25
District of Columbia	951,829	....	995,382	995,382	1,073,495	0.53
Florida	8,595,175	....	8,871,987	8,871,987	9,558,614	4.74
Georgia	4,450,437	....	4,406,404	4,406,404	4,640,267	2.30
Hawaii	630,044	....	652,681	652,681	644,960	0.32
Idaho	774,672	....	835,324	835,324	1,008,225	0.50
Illinois	6,433,637	....	5,872,990	5,872,990	6,132,957	3.04
Indiana	3,771,102	....	4,062,626	4,062,626	4,403,014	2.18
Iowa	1,625,436	....	1,679,021	1,679,021	1,715,427	0.85
Kansas	1,334,905	....	1,387,558	1,387,558	1,453,968	0.72
Kentucky	3,158,289	....	3,286,278	3,286,278	3,335,932	1.65
Louisiana	3,944,520	....	4,100,822	4,100,822	4,264,518	2.11
Maine	1,540,332	....	1,423,030	1,423,030	1,533,565	0.76
Maryland	2,606,399	....	2,677,410	2,677,410	2,805,031	1.39
Massachusetts	4,919,734	....	5,050,256	5,050,256	4,291,914	2.13
Michigan	5,398,062	....	5,065,730	5,065,730	5,091,493	2.52
Minnesota	3,235,118	....	2,706,072	2,706,072	3,316,311	1.64
Mississippi	2,834,870	....	3,009,721	3,009,721	3,152,946	1.56
Missouri	4,304,509	....	4,228,353	4,228,353	4,722,273	2.34
Montana	562,936	....	545,126	545,126	553,995	0.27
Nebraska	1,021,497	....	1,021,008	1,021,008	1,069,464	0.53
Nevada	727,428	....	742,806	742,806	780,076	0.39
New Hampshire	684,576	....	671,674	671,674	688,117	0.34
New Jersey	4,517,358	....	4,717,615	4,717,615	4,891,224	2.42
New Mexico	1,862,351	....	1,841,021	1,841,021	1,881,313	0.93
New York	24,343,119	....	25,447,882	25,447,882	26,401,883	13.08
North Carolina	5,892,636	....	6,397,389	6,397,389	6,830,984	3.38
North Dakota	384,432	....	361,666	361,666	364,165	0.18
Ohio	7,788,132	....	7,996,238	7,996,238	8,150,893	4.04
Oklahoma	2,100,680	....	2,359,041	2,359,041	2,538,406	1.26
Oregon	1,949,333	....	1,968,634	1,968,634	1,933,710	0.96
Pennsylvania	8,911,662	....	9,540,882	9,540,882	9,847,693	4.88
Rhode Island	1,021,498	....	1,047,514	1,047,514	1,074,794	0.53
South Carolina	3,043,808	....	2,952,684	2,952,684	3,042,411	1.51
South Dakota	461,802	....	517,223	517,223	504,594	0.25
Tennessee	5,382,360	....	5,115,714	5,115,714	5,275,831	2.61
Texas	11,226,479	....	11,610,127	11,610,127	12,188,121	6.04
Utah	1,070,165	....	1,085,901	1,085,901	1,158,024	0.57
Vermont	561,348	....	562,851	562,851	581,766	0.29
Virginia	2,469,787	....	2,478,575	2,478,575	2,636,931	1.31
Washington	3,242,853	....	3,279,893	3,279,893	3,366,081	1.67
West Virginia	1,703,864	....	1,698,661	1,698,661	1,856,759	0.92
Wisconsin	3,049,323	....	2,861,788	2,861,788	2,985,037	1.48
Wyoming	252,616	....	257,742	257,742	265,258	0.13
American Samoa	3,950	....	4,277	4,277	4,489	*
Guam	6,650	....	7,699	7,699	7,857	*
Northern Mariana Islands	2,383	....	2,542	2,542	2,663	*
Puerto Rico	219,600	....	255,888	255,888	274,051	0.14
Freely Associated States	....	....	....	....	....	....
Virgin Islands	6,886	....	7,790	7,790	8,270	*
Indian Tribes	....	....	....	....	....	....
Undistributed	....	....	....	....	....	....
Survey & Certification	175,165	....	252,000	252,000	256,900	0.13
Fraud Control Units	145,186	....	161,600	161,600	174,800	0.09
Vaccines for Children	1,503,127	....	1,957,963	1,957,963	2,006,445	0.99
Medicare Part B Transfer	242,289	....	300,000	300,000	350,000	0.17
Medicare Part D Transfer	72,800	....	19,800	19,800	18,000	0.01
Incurred But Not Reported	....	....	22,910,109	22,910,109	2,016,090	1.00
Adjustments	−204,908	....	−2,848,198	−2,848,198	−3,594,045	−1.78
Total	**193,197,944**	....	**215,563,672**	**215,563,672**	**201,829,235**	[1] **100.00**

* $500 or less or 0.005 percent or less.

[1] Excludes undistributed obligations.

Table 8–17. Temporary Assistance for Needy Families (TANF)—Family Assistance Grants (93.558a)

(obligations in thousands of dollars)

State or Territory	FY 2005 Actual	Estimated FY 2006 obligations from: Previous authority	New authority	Total	FY 2007 (estimated)	FY 2007 Percentage of distributed total
Alabama	122,626	....	104,408	104,408	104,408	0.60
Alaska	61,574	....	54,837	54,837	54,837	0.32
Arizona	226,417	....	226,131	226,131	226,131	1.31
Arkansas	65,788	....	62,951	62,951	62,951	0.36
California	3,693,923	....	3,671,818	3,671,818	3,671,815	21.26
Colorado	149,626	....	149,626	149,626	149,626	0.87
Connecticut	266,788	....	266,788	266,788	266,788	1.54
Delaware	33,319	....	32,291	32,291	32,291	0.19
District of Columbia	117,529	....	92,610	92,610	92,610	0.54
Florida	622,746	....	622,746	622,746	622,746	3.61
Georgia	372,028	....	368,025	368,025	368,025	2.13
Hawaii	99,247	....	98,905	98,905	98,905	0.57
Idaho	33,911	....	33,911	33,911	33,911	0.20
Illinois	585,809	....	585,057	585,057	585,057	3.39
Indiana	214,244	....	206,799	206,799	206,799	1.20
Iowa	137,828	....	131,525	131,525	131,525	0.76
Kansas	102,062	....	101,931	101,931	101,931	0.59
Kentucky	181,288	....	181,288	181,288	181,288	1.05
Louisiana	218,345	....	180,999	180,999	180,999	1.05
Maine	81,154	....	78,121	78,121	78,121	0.45
Maryland	229,098	....	229,098	229,098	229,098	1.33
Massachusetts	468,576	....	459,371	459,371	459,371	2.66
Michigan	780,507	....	775,353	775,353	775,353	4.49
Minnesota	278,697	....	263,434	263,434	263,434	1.53
Mississippi	114,974	....	95,803	95,803	95,803	0.55
Missouri	227,904	....	217,052	217,052	217,052	1.26
Montana	43,511	....	39,172	39,172	39,172	0.23
Nebraska	57,769	....	57,769	57,769	57,769	0.33
Nevada	47,386	....	47,647	47,647	47,647	0.28
New Hampshire	40,447	....	38,521	38,521	38,521	0.22
New Jersey	404,554	....	404,035	404,035	404,035	2.34
New Mexico	115,237	....	117,131	117,131	117,131	0.68
New York	2,487,312	....	2,442,931	2,442,931	2,442,931	14.15
North Carolina	338,350	....	338,350	338,350	338,350	1.96
North Dakota	27,720	....	26,400	26,400	26,400	0.15
Ohio	742,647	....	727,968	727,968	727,968	4.22
Oklahoma	153,797	....	147,594	147,594	147,594	0.85
Oregon	167,915	....	166,799	166,799	166,799	0.97
Pennsylvania	724,155	....	719,499	719,499	719,499	4.17
Rhode Island	97,883	....	95,022	95,022	95,022	0.55
South Carolina	124,960	....	99,968	99,968	99,968	0.58
South Dakota	21,721	....	21,280	21,280	21,280	0.12
Tennessee	260,941	....	213,089	213,089	213,089	1.23
Texas	544,850	....	538,965	538,965	538,965	3.12
Utah	112,996	....	84,314	84,314	84,314	0.49
Vermont	48,472	....	47,353	47,353	47,353	0.27
Virginia	166,199	....	158,285	158,285	158,285	0.92
Washington	392,665	....	382,854	382,854	382,854	2.22
West Virginia	110,318	....	110,176	110,176	110,176	0.64
Wisconsin	320,915	....	314,499	314,499	314,499	1.82
Wyoming	19,203	....	18,501	18,501	18,501	0.11
American Samoa	....	....	....	....	....	....
Guam	3,209	....	3,389	3,389	3,389	0.02
Northern Mariana Islands	....	....	....	....	....	....
Puerto Rico	71,563	....	71,563	71,563	71,563	0.41
Freely Associated States	....	....	....	....	....	....
Virgin Islands	2,847	....	2,847	2,847	2,847	0.02
Indian Tribes	141,096	....	159,120	159,120	159,120	0.92
Undistributed	....	....	....	....	....	....
Tribal New Program	7,558	....	7,633	7,633	7,633	0.04
Responsible Fatherhood	....	....	150,000	150,000	150,000	0.87
Family Formation Match	....	....	....	....	100,000	0.58
Contingency Fund (CF) Usage [1]	....	....	132,076	132,076	112,076	0.65
Territories Matching Fund	....	....	15,000	15,000	15,000	0.09
Total [2]	**17,284,204**	....	**17,190,628**	**17,190,628**	**17,270,625**	[3] **100.00**

[1] Unobligated contingency fund balances were $1,958 million in FY 2005, and are estimated to be $1,900 million in FY 2006, and $2,000 million in FY 2007.

[2] Includes State Family Assistance Grants, and Supplemental Population Grants, Grants to Tribes, and Contingency Fund. FY 2005 also includes High Performance Bonus, Illegitimacy Bonus, and Federal Loans for Hurricane Katrina.

[3] Excludes undistributed obligations.

Table 8–18. Child Support Enforcement—Federal Share of State and Local Administrative Costs and Incentives (93.563)

(obligations in thousands of dollars)

State or Territory	FY 2005 Actual	Estimated FY 2006 obligations from: Previous authority	New authority	Total	FY 2007 (estimated)	FY 2007 Percentage of distributed total
Alabama	46,524	....	46,313	46,313	46,183	1.13
Alaska	14,223	....	14,159	14,159	14,119	0.35
Arizona	46,439	....	46,228	46,228	46,099	1.13
Arkansas	32,708	....	32,560	32,560	32,469	0.80
California	868,224	....	864,276	864,276	861,861	21.17
Colorado	48,576	....	48,355	48,355	48,220	1.18
Connecticut	54,585	....	54,337	54,337	54,185	1.33
Delaware	16,105	....	16,032	16,032	15,987	0.39
District of Columbia	7,674	....	7,639	7,639	7,618	0.19
Florida	192,972	....	192,096	192,096	191,558	4.71
Georgia	79,003	....	78,644	78,644	78,424	1.93
Hawaii	11,893	....	11,839	11,839	11,806	0.29
Idaho	32,741	....	32,592	32,592	32,501	0.80
Illinois	123,578	....	123,017	123,017	122,673	3.01
Indiana	64,292	....	64,000	64,000	63,821	1.57
Iowa	31,878	....	31,733	31,733	31,644	0.78
Kansas	48,567	....	48,347	48,347	48,211	1.18
Kentucky	31,647	....	31,503	31,503	31,415	0.77
Louisiana	61,396	....	61,117	61,117	60,946	1.50
Maine	11,214	....	11,163	11,163	11,131	0.27
Maryland	93,157	....	92,734	92,734	92,475	2.27
Massachusetts	103,527	....	103,057	103,057	102,769	2.52
Michigan	135,871	....	135,254	135,254	134,876	3.31
Minnesota	93,256	....	92,832	92,832	92,573	2.27
Mississippi	34,895	....	34,736	34,736	34,639	0.85
Missouri	54,558	....	54,310	54,310	54,158	1.33
Montana	12,241	....	12,185	12,185	12,151	0.30
Nebraska	36,168	....	36,004	36,004	35,903	0.88
Nevada	32,015	....	31,869	31,869	31,780	0.78
New Hampshire	26,728	....	26,606	26,606	26,532	0.65
New Jersey	124,433	....	123,868	123,868	123,521	3.03
New Mexico	53,534	....	53,291	53,291	53,142	1.31
New York	192,598	....	191,723	191,723	191,187	4.70
North Carolina	72,550	....	72,220	72,220	72,018	1.77
North Dakota	40,644	....	40,459	40,459	40,346	0.99
Ohio	208,668	....	207,719	207,719	207,138	5.09
Oklahoma	34,715	....	34,558	34,558	34,461	0.85
Oregon	65,136	....	64,841	64,841	64,659	1.59
Pennsylvania	128,630	....	128,046	128,046	127,688	3.14
Rhode Island	1,707	....	1,700	1,700	1,695	0.04
South Carolina	32,326	....	32,179	32,179	32,089	0.79
South Dakota	53,220	....	52,979	52,979	52,830	1.30
Tennessee	55,849	....	55,595	55,595	55,440	1.36
Texas	180,975	....	180,153	180,153	179,649	4.41
Utah	41,113	....	40,926	40,926	40,812	1.00
Vermont	40,728	....	40,543	40,543	40,430	0.99
Virginia	66,200	....	65,899	65,899	65,715	1.61
Washington	72,643	....	72,313	72,313	72,110	1.77
West Virginia	20,852	....	20,758	20,758	20,700	0.51
Wisconsin	78,932	....	78,574	78,574	78,354	1.92
Wyoming	6,041	....	6,014	6,014	5,997	0.15
American Samoa	....	....	....	....	....	....
Guam	6,902	....	6,870	6,870	6,851	0.17
Northern Mariana Islands	....	....	....	....	....	....
Puerto Rico	33,169	....	33,018	33,018	32,927	0.81
Freely Associated States	....	....	....	....	....	....
Virgin Islands	12,769	....	12,711	12,711	12,676	0.31
Indian Tribes	12,502	....	17,000	17,000	30,000	0.74
Undistributed	....	....	....	....	....	....
Total	**4,083,491**	....	**4,069,494**	**4,069,494**	**4,071,162**	[1] **100.00**

[1] Excludes undistributed obligations.

Table 8–19. Low Income Home Energy Assistance Program (93.568a)

(obligations in thousands of dollars)

State or Territory	FY 2005 Actual	Estimated FY 2006 obligations from:			FY 2007 (estimated)	FY 2007 Percentage of distributed total
		Previous authority	New authority	Total		
Alabama	15,851	....	16,664	16,664	17,635	0.87
Alaska	6,928	....	7,440	7,440	7,525	0.37
Arizona	7,084	....	7,448	7,448	7,882	0.39
Arkansas	12,172	....	12,796	12,796	13,542	0.67
California	84,940	....	89,287	89,287	94,490	4.65
Colorado	29,812	....	31,342	31,342	31,704	1.56
Connecticut	38,923	....	40,920	40,920	41,392	2.04
Delaware	5,166	....	5,431	5,431	5,748	0.28
District of Columbia	6,045	....	6,355	6,355	6,428	0.32
Florida	25,233	....	26,527	26,527	28,073	1.38
Georgia	19,956	....	20,979	20,979	22,202	1.09
Hawaii	2,010	....	2,113	2,113	2,137	0.11
Idaho	11,074	....	11,642	11,642	11,776	0.58
Illinois	107,733	....	113,259	113,259	119,296	5.87
Indiana	48,770	....	51,274	51,274	51,865	2.55
Iowa	34,570	....	36,343	36,343	36,762	1.81
Kansas	15,864	....	16,678	16,678	17,651	0.87
Kentucky	25,384	....	26,686	26,686	28,241	1.39
Louisiana	16,308	....	17,144	17,144	18,143	0.89
Maine	24,295	....	25,541	25,541	25,835	1.27
Maryland	29,803	....	31,332	31,332	33,158	1.63
Massachusetts	77,829	....	81,820	81,820	82,764	4.07
Michigan	101,670	....	106,792	106,792	108,028	5.32
Minnesota	73,689	....	77,469	77,469	78,363	3.86
Mississippi	13,650	....	14,350	14,350	15,186	0.75
Missouri	43,033	....	45,240	45,240	47,877	2.36
Montana	11,584	....	12,178	12,178	12,319	0.61
Nebraska	17,093	....	17,970	17,970	18,177	0.89
Nevada	3,623	....	3,809	3,809	4,031	0.20
New Hampshire	14,737	....	15,493	15,493	15,672	0.77
New Jersey	72,100	....	75,798	75,798	76,672	3.77
New Mexico	8,841	....	9,392	9,392	9,501	0.47
New York	235,610	....	247,980	247,980	250,841	12.34
North Carolina	34,547	....	36,319	36,319	38,435	1.89
North Dakota	12,108	....	12,174	12,174	12,315	0.61
Ohio	95,306	....	100,195	100,195	101,350	4.99
Oklahoma	13,371	....	14,008	14,008	14,826	0.73
Oregon	22,718	....	23,880	23,880	24,158	1.19
Pennsylvania	126,771	....	133,273	133,273	134,810	6.63
Rhode Island	12,780	....	13,435	13,435	13,590	0.67
South Carolina	12,669	....	13,318	13,318	14,095	0.69
South Dakota	9,903	....	10,410	10,410	10,531	0.52
Tennessee	25,714	....	27,033	27,033	28,608	1.41
Texas	41,991	....	44,144	44,144	46,717	2.30
Utah	13,581	....	14,285	14,285	14,452	0.71
Vermont	11,046	....	11,613	11,613	11,747	0.58
Virginia	36,304	....	38,166	38,166	40,390	1.99
Washington	36,495	....	38,367	38,367	38,810	1.91
West Virginia	16,799	....	17,660	17,660	18,690	0.92
Wisconsin	66,331	....	69,733	69,733	70,538	3.47
Wyoming	5,341	....	5,626	5,626	5,693	0.28
American Samoa	42	....	44	44	45	*
Guam	91	....	96	96	98	*
Northern Mariana Islands	32	....	33	33	34	*
Puerto Rico	2,264	....	2,381	2,381	2,444	0.12
Freely Associated States	....	....	....	....	....	....
Virgin Islands	86	....	91	91	93	*
Indian Tribes	19,552	....	20,702	20,702	21,093	1.04
Undistributed	....	....	....	....	....	....
Discretionary Funds	27,280	....	27,225	27,225	27,225	1.34
Technical Assistance	297	....	297	297	297	0.01
Lapse	−3	....	....	....	....	....
Total	**1,884,796**	....	**1,980,000**	**1,980,000**	**2,032,000**	[1] **100.00**

* $500 or less or 0.005 percent or less.
[1] Excludes undistributed obligations.

Table 8–20. Child Care and Development Block Grant (93.575)

(obligations in thousands of dollars)

State or Territory	FY 2005 Actual	Estimated FY 2006 obligations from: Previous authority	New authority	Total	FY 2007 (estimated)	FY 2007 Percentage of distributed total
Alabama	41,574	....	40,569	40,569	40,569	1.97
Alaska	4,059	....	4,032	4,032	4,032	0.20
Arizona	49,265	....	49,980	49,980	49,980	2.42
Arkansas	25,161	....	24,687	24,687	24,687	1.20
California	229,313	....	229,046	229,046	229,046	11.11
Colorado	23,440	....	23,742	23,742	23,742	1.15
Connecticut	14,528	....	14,308	14,308	14,308	0.69
Delaware	4,605	....	4,527	4,527	4,527	0.22
District of Columbia	3,279	....	3,097	3,097	3,097	0.15
Florida	113,701	....	114,859	114,859	114,859	5.57
Georgia	74,993	....	75,707	75,707	75,707	3.67
Hawaii	8,440	....	8,102	8,102	8,102	0.39
Idaho	11,593	....	11,588	11,588	11,588	0.56
Illinois	78,276	....	75,972	75,972	75,972	3.68
Indiana	41,626	....	41,415	41,415	41,415	2.01
Iowa	18,473	....	18,222	18,222	18,222	0.88
Kansas	19,030	....	18,827	18,827	18,827	0.91
Kentucky	36,066	....	35,447	35,447	35,447	1.72
Louisiana	48,102	....	47,004	47,004	47,004	2.28
Maine	6,964	....	6,854	6,854	6,854	0.33
Maryland	27,004	....	26,273	26,273	26,273	1.27
Massachusetts	26,245	....	25,617	25,617	25,617	1.24
Michigan	59,474	....	58,727	58,727	58,727	2.85
Minnesota	25,914	....	25,804	25,804	25,804	1.25
Mississippi	33,165	....	32,286	32,286	32,286	1.57
Missouri	39,484	....	38,888	38,888	38,888	1.89
Montana	5,878	....	5,701	5,701	5,701	0.28
Nebraska	12,008	....	11,888	11,888	11,888	0.58
Nevada	13,304	....	13,532	13,532	13,532	0.66
New Hampshire	4,892	....	4,724	4,724	4,724	0.23
New Jersey	37,391	....	36,875	36,875	36,875	1.79
New Mexico	18,814	....	18,524	18,524	18,524	0.90
New York	109,665	....	107,494	107,494	107,494	5.21
North Carolina	65,039	....	65,054	65,054	65,054	3.15
North Dakota	4,027	....	3,833	3,833	3,833	0.19
Ohio	68,800	....	67,685	67,685	67,685	3.28
Oklahoma	31,773	....	31,240	31,240	31,240	1.51
Oregon	22,331	....	22,325	22,325	22,325	1.08
Pennsylvania	62,848	....	62,762	62,762	62,762	3.04
Rhode Island	5,964	....	5,811	5,811	5,811	0.28
South Carolina	37,591	....	37,056	37,056	37,056	1.80
South Dakota	5,875	....	5,726	5,726	5,726	0.28
Tennessee	45,486	....	45,109	45,109	45,109	2.19
Texas	210,972	....	210,983	210,983	210,983	10.23
Utah	22,446	....	22,359	22,359	22,359	1.08
Vermont	2,994	....	2,946	2,946	2,946	0.14
Virginia	40,274	....	39,834	39,834	39,834	1.93
Washington	33,571	....	33,006	33,006	33,006	1.60
West Virginia	14,289	....	13,682	13,682	13,682	0.66
Wisconsin	30,374	....	29,783	29,783	29,783	1.44
Wyoming	2,886	....	2,803	2,803	2,803	0.14
American Samoa	2,515	....	2,681	2,681	2,681	0.13
Guam	4,191	....	4,064	4,064	4,064	0.20
Northern Mariana Islands	1,594	....	1,700	1,700	1,700	0.08
Puerto Rico	41,463	....	38,255	38,255	38,255	1.86
Freely Associated States	....	....	....	....	....	....
Virgin Islands	2,115	....	1,866	1,866	1,866	0.09
Indian Tribes	41,658	....	41,242	41,242	41,242	2.00
Undistributed	....	....	....	....	....	....
Technical Assistance	5,207	....	5,155	5,155	5,155	0.25
Research Set-Aside	9,920	....	9,821	9,821	9,821	0.48
Child Care Aware	992	....	982	982	982	0.05
Total	**2,082,921**	....	**2,062,081**	**2,062,081**	**2,062,081**	[1] **100.00**

[1] Excludes undistributed obligations.

Table 8–21. Child Care and Development Fund—Mandatory (93.596a)

(obligations in thousands of dollars)

State or Territory	FY 2005 Actual	Estimated FY 2006 obligations from: Previous authority	New authority	Total	FY 2007 (estimated)	FY 2007 Percentage of distributed total
Alabama	16,442	....	16,442	16,442	16,442	1.33
Alaska	3,545	....	3,545	3,545	3,545	0.29
Arizona	19,827	....	19,827	19,827	19,827	1.60
Arkansas	5,300	....	5,300	5,300	5,300	0.43
California	85,593	....	85,593	85,593	85,593	6.90
Colorado	10,174	....	10,174	10,174	10,174	0.82
Connecticut	18,738	....	18,738	18,738	18,738	1.51
Delaware	5,179	....	5,179	5,179	5,179	0.42
District of Columbia	4,567	....	4,567	4,567	4,567	0.37
Florida	43,027	....	43,027	43,027	43,027	3.47
Georgia	36,548	....	36,548	36,548	36,548	2.95
Hawaii	4,972	....	4,972	4,972	4,972	0.40
Idaho	2,868	....	2,868	2,868	2,868	0.23
Illinois	56,874	....	56,874	56,874	56,874	4.59
Indiana	26,182	....	26,182	26,182	26,182	2.11
Iowa	8,508	....	8,508	8,508	8,508	0.69
Kansas	9,812	....	9,812	9,812	9,812	0.79
Kentucky	16,702	....	16,702	16,702	16,702	1.35
Louisiana	13,865	....	13,865	13,865	13,865	1.12
Maine	3,019	....	3,019	3,019	3,019	0.24
Maryland	23,301	....	23,301	23,301	23,301	1.88
Massachusetts	44,973	....	44,973	44,973	44,973	3.63
Michigan	32,082	....	32,082	32,082	32,082	2.59
Minnesota	23,368	....	23,368	23,368	23,368	1.89
Mississippi	6,293	....	6,293	6,293	6,293	0.51
Missouri	24,669	....	24,669	24,669	24,669	1.99
Montana	3,191	....	3,191	3,191	3,191	0.26
Nebraska	10,595	....	10,595	10,595	10,595	0.85
Nevada	2,580	....	2,580	2,580	2,580	0.21
New Hampshire	4,582	....	4,582	4,582	4,582	0.37
New Jersey	26,374	....	26,374	26,374	26,374	2.13
New Mexico	8,308	....	8,308	8,308	8,308	0.67
New York	101,981	....	101,981	101,981	101,981	8.23
North Carolina	69,639	....	69,639	69,639	69,639	5.62
North Dakota	2,506	....	2,506	2,506	2,506	0.20
Ohio	70,125	....	70,125	70,125	70,125	5.66
Oklahoma	24,910	....	24,910	24,910	24,910	2.01
Oregon	19,409	....	19,409	19,409	19,409	1.57
Pennsylvania	55,337	....	55,337	55,337	55,337	4.46
Rhode Island	6,634	....	6,634	6,634	6,634	0.54
South Carolina	9,867	....	9,867	9,867	9,867	0.80
South Dakota	1,711	....	1,711	1,711	1,711	0.14
Tennessee	37,702	....	37,702	37,702	37,702	3.04
Texas	59,844	....	59,844	59,844	59,844	4.83
Utah	12,592	....	12,592	12,592	12,592	1.02
Vermont	3,945	....	3,945	3,945	3,945	0.32
Virginia	21,329	....	21,329	21,329	21,329	1.72
Washington	41,883	....	41,883	41,883	41,883	3.38
West Virginia	8,727	....	8,727	8,727	8,727	0.70
Wisconsin	24,511	....	24,511	24,511	24,511	1.98
Wyoming	2,815	....	2,815	2,815	2,815	0.23
American Samoa	....	....	....	....	....	....
Guam	....	....	....	....	....	....
Northern Mariana Islands	....	....	....	....	....	....
Puerto Rico	....	....	....	....	....	....
Freely Associated States	....	....	....	....	....	....
Virgin Islands	....	....	....	....	....	....
Indian Tribes	54,340	....	58,340	58,340	58,340	4.71
Undistributed	....	....	....	....	....	....
Technical Assistance	3,532	....	3,792	3,792	3,792	0.31
Total	**1,235,397**	....	**1,239,657**	**1,239,657**	**1,239,657**	[1] **100.00**

[1] Excludes undistributed obligations.

Table 8–22. Child Care and Development Fund—Matching (93.596b)

(obligations in thousands of dollars)

State or Territory	FY 2005 Actual	Estimated FY 2006 obligations from:			FY 2007 (estimated)	FY 2007 Percentage of distributed total
		Previous authority	New authority	Total		
Alabama	22,358	....	24,871	24,871	24,871	1.48
Alaska	3,821	....	4,196	4,196	4,196	0.25
Arizona	30,878	....	36,179	36,179	36,179	2.16
Arkansas	13,716	....	15,435	15,435	15,435	0.92
California	196,682	....	221,032	221,032	221,032	13.18
Colorado	23,697	....	27,294	27,294	27,294	1.63
Connecticut	17,909	....	18,908	18,908	18,908	1.13
Delaware	3,888	....	4,413	4,413	4,413	0.26
District of Columbia	2,436	....	2,622	2,622	2,622	0.16
Florida	79,163	....	90,962	90,962	90,962	5.42
Georgia	47,211	....	54,150	54,150	54,150	3.23
Hawaii	6,126	....	6,906	6,906	6,906	0.41
Idaho	7,521	....	8,507	8,507	8,507	0.51
Illinois	67,355	....	74,544	74,544	74,544	4.44
Indiana	32,759	....	36,639	36,639	36,639	2.18
Iowa	14,021	....	15,300	15,300	15,300	0.91
Kansas	14,013	....	15,576	15,576	15,576	0.93
Kentucky	19,025	....	22,416	22,416	22,416	1.34
Louisiana	23,873	....	26,556	26,556	26,556	1.58
Maine	5,359	....	6,089	6,089	6,089	0.36
Maryland	28,034	....	31,566	31,566	31,566	1.88
Massachusetts	29,913	....	33,216	33,216	33,216	1.98
Michigan	51,750	....	56,925	56,925	56,925	3.39
Minnesota	25,061	....	27,892	27,892	27,892	1.66
Mississippi	15,583	....	17,143	17,143	17,143	1.02
Missouri	28,243	....	31,256	31,256	31,256	1.86
Montana	4,209	....	4,539	4,539	4,539	0.27
Nebraska	8,882	....	9,900	9,900	9,900	0.59
Nevada	12,083	....	14,123	14,123	14,123	0.84
New Hampshire	6,123	....	6,673	6,673	6,673	0.40
New Jersey	43,941	....	49,344	49,344	49,344	2.94
New Mexico	10,091	....	11,102	11,102	11,102	0.66
New York	94,784	....	104,120	104,120	104,120	6.21
North Carolina	43,067	....	48,955	48,955	48,955	2.92
North Dakota	2,875	....	3,066	3,066	3,066	0.18
Ohio	58,693	....	62,770	62,770	62,770	3.74
Oklahoma	17,777	....	19,683	19,683	19,683	1.17
Oregon	17,378	....	19,321	19,321	19,321	1.15
Pennsylvania	57,297	....	62,964	62,964	62,964	3.75
Rhode Island	4,856	....	5,458	5,458	5,458	0.33
South Carolina	19,968	....	23,232	23,232	23,232	1.39
South Dakota	3,882	....	4,282	4,282	4,282	0.26
Tennessee	28,869	....	31,806	31,806	31,806	1.90
Texas	126,491	....	146,323	146,323	146,323	8.72
Utah	9,822	....	17,634	17,634	17,634	1.05
Vermont	2,699	....	2,880	2,880	2,880	0.17
Virginia	36,138	....	41,242	41,242	41,242	2.46
Washington	30,471	....	33,507	33,507	33,507	2.00
West Virginia	7,781	....	8,633	8,633	8,633	0.51
Wisconsin	26,659	....	29,114	29,114	29,114	1.74
Wyoming	2,350	....	2,578	2,578	2,578	0.15
American Samoa	....	....	....	....	....	....
Guam	....	....	....	....	....	....
Northern Mariana Islands	....	....	....	....	....	....
Puerto Rico	....	....	....	....	....	....
Freely Associated States	....	....	....	....	....	....
Virgin Islands	....	....	....	....	....	....
Indian Tribes	....	....	....	....	....	....
Undistributed	....	....	....	....	....	....
Technical Assistance	3,260	....	3,501	3,501	3,501	0.21
Total	[1] **1,490,841**	....	**1,677,343**	**1,677,343**	**1,677,343**	[2] **100.00**

[1] Includes reappropriated funds from prior years.
[2] Excludes undistributed obligations.

Table 8–23. Head Start (93.600)

(obligations in thousands of dollars)

State or Territory	FY 2005 Actual	Estimated FY 2006 obligations from: Previous authority	New authority	Total	FY 2007 (estimated)	FY 2007 Percentage of distributed total
Alabama	106,345	....	105,446	105,446	105,446	1.55
Alaska	12,439	....	12,334	12,334	12,334	0.18
Arizona	103,225	....	102,352	102,352	102,352	1.51
Arkansas	64,355	....	63,810	63,810	63,810	0.94
California	829,441	....	822,424	822,424	822,424	12.12
Colorado	68,157	....	67,580	67,580	67,580	1.00
Connecticut	51,760	....	51,322	51,322	51,322	0.76
Delaware	13,201	....	13,089	13,089	13,089	0.19
District of Columbia	25,041	....	24,829	24,829	24,829	0.37
Florida	262,433	....	260,213	260,213	260,213	3.83
Georgia	168,059	....	166,637	166,637	166,637	2.46
Hawaii	22,825	....	22,632	22,632	22,632	0.33
Idaho	22,753	....	22,561	22,561	22,561	0.33
Illinois	270,041	....	267,757	267,757	267,757	3.95
Indiana	95,943	....	95,132	95,132	95,132	1.40
Iowa	51,412	....	50,977	50,977	50,977	0.75
Kansas	50,791	....	50,361	50,361	50,361	0.74
Kentucky	107,558	....	106,648	106,648	106,648	1.57
Louisiana	145,513	....	144,282	144,282	144,282	2.13
Maine	27,537	....	27,304	27,304	27,304	0.40
Maryland	77,826	....	77,168	77,168	77,168	1.14
Massachusetts	108,061	....	107,147	107,147	107,147	1.58
Michigan	233,924	....	231,945	231,945	231,945	3.42
Minnesota	71,811	....	71,204	71,204	71,204	1.05
Mississippi	161,258	....	159,894	159,894	159,894	2.36
Missouri	118,674	....	117,670	117,670	117,670	1.73
Montana	20,893	....	20,716	20,716	20,716	0.31
Nebraska	35,962	....	35,658	35,658	35,658	0.53
Nevada	24,215	....	24,010	24,010	24,010	0.35
New Hampshire	13,350	....	13,237	13,237	13,237	0.20
New Jersey	128,669	....	127,581	127,581	127,581	1.88
New Mexico	52,160	....	51,719	51,719	51,719	0.76
New York	432,037	....	428,382	428,382	428,382	6.31
North Carolina	140,898	....	139,706	139,706	139,706	2.06
North Dakota	17,129	....	16,984	16,984	16,984	0.25
Ohio	246,237	....	244,154	244,154	244,154	3.60
Oklahoma	80,833	....	80,150	80,150	80,150	1.18
Oregon	59,311	....	58,809	58,809	58,809	0.87
Pennsylvania	227,563	....	225,638	225,638	225,638	3.33
Rhode Island	21,956	....	21,771	21,771	21,771	0.32
South Carolina	82,282	....	81,586	81,586	81,586	1.20
South Dakota	18,775	....	18,616	18,616	18,616	0.27
Tennessee	119,022	....	118,015	118,015	118,015	1.74
Texas	477,434	....	473,394	473,394	473,394	6.98
Utah	37,664	....	37,345	37,345	37,345	0.55
Vermont	13,523	....	13,409	13,409	13,409	0.20
Virginia	98,833	....	97,997	97,997	97,997	1.44
Washington	100,094	....	99,248	99,248	99,248	1.46
West Virginia	50,508	....	50,081	50,081	50,081	0.74
Wisconsin	90,635	....	89,869	89,869	89,869	1.32
Wyoming	12,338	....	12,234	12,234	12,234	0.18
American Samoa	2,144	....	2,126	2,126	2,126	0.03
Guam	2,158	....	2,140	2,140	2,140	0.03
Northern Mariana Islands	1,660	....	1,646	1,646	1,646	0.02
Puerto Rico	248,652	....	246,548	246,548	246,548	3.63
Freely Associated States	....	....	....	....	....	....
Virgin Islands	7,976	....	7,908	7,908	7,908	0.12
Indian Tribes	186,937	....	185,355	185,355	185,355	2.73
Undistributed	....	....	....	....	....	....
Palau	1,330	....	1,319	1,319	1,319	0.02
Migrant Program	285,729	....	283,312	283,312	283,312	4.18
Unallocated Expansion	....	....	....	....	66,830	0.98
Technical Assistance	174,078	....	172,644	172,644	105,814	1.56
Research, Development, & Education	20,000	....	20,000	20,000	20,000	0.29
Program Support	38,980	....	39,746	39,746	39,746	0.59
Hurricane Relief	....	....	90,000	[1] 90,000	....	....
Total	**6,842,348**	....	**6,875,771**	**6,875,771**	**6,785,771**	[2] **100.00**

[1] Hurricane relief funding will be distributed by State once grantee needs are determined.
[2] Excludes undistributed obligations.

Table 8–24. Foster Care—Title IV–E (93.658)

(obligations in thousands of dollars)

State or Territory	FY 2005 Actual	Estimated FY 2006 obligations from: Previous authority	New authority	Total	FY 2007 (estimated)	FY 2007 Percentage of distributed total
Alabama	22,753	....	24,116	24,116	24,789	0.52
Alaska	19,542	....	20,713	20,713	21,291	0.44
Arizona	79,927	....	84,717	84,717	87,080	1.82
Arkansas	31,437	....	33,321	33,321	34,250	0.72
California	1,081,925	....	1,146,754	1,146,754	1,178,747	24.63
Colorado	51,711	....	54,810	54,810	56,339	1.18
Connecticut	85,176	....	90,280	90,280	92,799	1.94
Delaware	4,937	....	5,233	5,233	5,379	0.11
District of Columbia	21,347	....	22,626	22,626	23,257	0.49
Florida	136,809	....	145,006	145,006	149,052	3.11
Georgia	68,401	....	72,500	72,500	74,522	1.56
Hawaii	23,912	....	25,345	25,345	26,052	0.54
Idaho	8,413	....	8,917	8,917	9,165	0.19
Illinois	255,717	....	271,040	271,040	278,601	5.82
Indiana	61,678	....	65,374	65,374	67,198	1.40
Iowa	23,354	....	24,753	24,753	25,444	0.53
Kansas	32,145	....	34,071	34,071	35,022	0.73
Kentucky	50,856	....	53,904	53,904	55,408	1.16
Louisiana	63,977	....	67,811	67,811	69,703	1.46
Maine	3,259	....	3,454	3,454	3,551	0.07
Maryland	130,274	....	138,080	138,080	141,933	2.97
Massachusetts	44,908	....	47,599	47,599	48,927	1.02
Michigan	117,123	....	124,141	124,141	127,605	2.67
Minnesota	70,957	....	75,209	75,209	77,307	1.62
Mississippi	6,409	....	6,793	6,793	6,983	0.15
Missouri	52,873	....	56,041	56,041	57,604	1.20
Montana	11,472	....	12,159	12,159	12,499	0.26
Nebraska	24,763	....	26,247	26,247	26,979	0.56
Nevada	24,286	....	25,741	25,741	26,459	0.55
New Hampshire	18,111	....	19,196	19,196	19,732	0.41
New Jersey	53,540	....	56,749	56,749	58,332	1.22
New Mexico	15,928	....	16,882	16,882	17,353	0.36
New York	451,539	....	478,596	478,596	491,949	10.28
North Carolina	63,943	....	67,775	67,775	69,666	1.46
North Dakota	10,566	....	11,199	11,199	11,512	0.24
Ohio	227,479	....	241,110	241,110	247,836	5.18
Oklahoma	34,348	....	36,406	36,406	37,422	0.78
Oregon	50,486	....	53,511	53,511	55,004	1.15
Pennsylvania	310,370	....	328,967	328,967	338,145	7.07
Rhode Island	10,942	....	11,598	11,598	11,922	0.25
South Carolina	10,220	....	10,833	10,833	11,135	0.23
South Dakota	4,284	....	4,541	4,541	4,668	0.10
Tennessee	26,606	....	28,200	28,200	28,987	0.61
Texas	215,896	....	228,833	228,833	235,217	4.91
Utah	23,566	....	24,978	24,978	25,675	0.54
Vermont	10,296	....	10,913	10,913	11,217	0.23
Virginia	41,596	....	44,089	44,089	45,319	0.95
Washington	77,033	....	81,649	81,649	83,927	1.75
West Virginia	22,428	....	23,772	23,772	24,435	0.51
Wisconsin	62,793	....	66,555	66,555	68,412	1.43
Wyoming	1,188	....	1,259	1,259	1,295	0.03
American Samoa	....	....	....	....	....	....
Guam	....	....	....	....	....	....
Northern Mariana Islands	....	....	....	....	....	....
Puerto Rico	1,462	....	1,550	1,550	1,593	0.03
Freely Associated States	....	....	....	....	....	....
Virgin Islands	....	....	....	....	....	....
Indian Tribes	....	....	....	....	....	....
Undistributed	....	....	....	....	....	....
Technical Assistance	16,237	....	17,084	17,084	16,302	0.34
New Program Option	....	....	....	....	25,000	0.52
Total	**4,371,198**	....	[1] **4,633,000**	**4,633,000**	**4,786,000**	[2] **100.00**

[1] Assumes a lapse of $52 million.
[2] Excludes undistributed obligations.

Table 8–25. Adoption Assistance (93.659)

(obligations in thousands of dollars)

State or Territory	FY 2005 Actual	Estimated FY 2006 obligations from:			FY 2007 (estimated)	FY 2007 Percentage of distributed total
		Previous authority	New authority	Total		
Alabama	6,920	....	7,611	7,611	8,274	0.40
Alaska	7,673	....	8,439	8,439	9,174	0.45
Arizona	25,983	....	28,576	28,576	31,065	1.52
Arkansas	10,298	....	11,326	11,326	12,312	0.60
California	291,225	....	320,285	320,285	348,182	17.01
Colorado	21,145	....	23,256	23,256	25,281	1.24
Connecticut	21,855	....	24,036	24,036	26,129	1.28
Delaware	1,702	....	1,872	1,872	2,035	0.10
District of Columbia	7,887	....	8,674	8,674	9,430	0.46
Florida	51,241	....	56,355	56,355	61,264	2.99
Georgia	33,749	....	37,118	37,118	40,351	1.97
Hawaii	9,537	....	10,489	10,489	11,402	0.56
Idaho	2,967	....	3,263	3,263	3,548	0.17
Illinois	83,122	....	91,418	91,418	99,380	4.85
Indiana	32,325	....	35,551	35,551	38,647	1.89
Iowa	32,654	....	35,913	35,913	39,041	1.91
Kansas	9,059	....	9,963	9,963	10,830	0.53
Kentucky	22,584	....	24,838	24,838	27,002	1.32
Louisiana	12,887	....	14,173	14,173	15,407	0.75
Maine	13,380	....	14,715	14,715	15,997	0.78
Maryland	19,300	....	21,227	21,227	23,075	1.13
Massachusetts	31,544	....	34,692	34,692	37,714	1.84
Michigan	102,888	....	113,156	113,156	123,012	6.01
Minnesota	22,519	....	24,766	24,766	26,923	1.32
Mississippi	4,129	....	4,542	4,542	4,937	0.24
Missouri	28,645	....	31,504	31,504	34,248	1.67
Montana	4,267	....	4,692	4,692	5,101	0.25
Nebraska	8,557	....	9,411	9,411	10,231	0.50
Nevada	8,564	....	9,419	9,419	10,240	0.50
New Hampshire	4,186	....	4,604	4,604	5,005	0.24
New Jersey	30,055	....	33,055	33,055	35,934	1.76
New Mexico	11,318	....	12,448	12,448	13,532	0.66
New York	219,823	....	241,762	241,762	262,818	12.84
North Carolina	27,887	....	30,670	30,670	33,341	1.63
North Dakota	3,083	....	3,391	3,391	3,686	0.18
Ohio	145,842	....	160,397	160,397	174,367	8.52
Oklahoma	19,944	....	21,935	21,935	23,845	1.16
Oregon	28,968	....	31,860	31,860	34,634	1.69
Pennsylvania	75,182	....	82,685	82,685	89,886	4.39
Rhode Island	9,216	....	10,136	10,136	11,019	0.54
South Carolina	11,700	....	12,868	12,868	13,989	0.68
South Dakota	2,567	....	2,823	2,823	3,069	0.15
Tennessee	18,161	....	19,974	19,974	21,713	1.06
Texas	55,048	....	60,542	60,542	65,815	3.22
Utah	6,800	....	7,478	7,478	8,130	0.40
Vermont	7,880	....	8,667	8,667	9,421	0.46
Virginia	15,235	....	16,755	16,755	18,214	0.89
Washington	29,941	....	32,929	32,929	35,797	1.75
West Virginia	12,722	....	13,992	13,992	15,211	0.74
Wisconsin	46,937	....	51,622	51,622	56,118	2.74
Wyoming	547	....	602	602	654	0.03
American Samoa	....	....	....	....	....	....
Guam	....	....	....	....	....	....
Northern Mariana Islands	....	....	....	....	....	....
Puerto Rico	477	....	525	525	570	0.03
Freely Associated States	....	....	....	....	....	....
Virgin Islands	....	....	....	....	....	....
Indian Tribes	....	....	....	....	....	....
Undistributed	....	....	....	....	....	....
Total	**1,712,125**	....	**1,883,000**	**1,883,000**	**2,047,000**	[1] **100.00**

[1] Excludes undistributed obligations.

Table 8–26. Homeland Security Grant Program (97.067)

(obligations in thousands of dollars)

State or Territory	FY 2005 Actual	Estimated FY 2006 obligations from: Previous authority	New authority	Total	FY 2007 (estimated)	FY 2007 Percentage of distributed total
Alabama	28,153	....	8,090	8,090	5,093	1.85
Alaska	14,879	....	7,476	7,476	4,829	1.75
Arizona	41,705	....	8,143	8,143	5,187	1.88
Arkansas	21,561	....	7,325	7,325	4,973	1.80
California	282,622	....	12,553	12,553	7,235	2.63
Colorado	36,799	....	7,862	7,862	5,101	1.85
Connecticut	24,080	....	7,353	7,353	5,022	1.82
Delaware	14,984	....	7,019	7,019	4,841	1.76
District of Columbia	96,144	....	7,007	7,007	4,822	1.75
Florida	101,285	....	9,294	9,294	5,991	2.17
Georgia	54,918	....	7,799	7,799	5,400	1.96
Hawaii	23,130	....	7,267	7,267	4,871	1.77
Idaho	16,805	....	7,041	7,041	4,881	1.77
Illinois	102,593	....	7,708	7,708	5,650	2.05
Indiana	38,996	....	7,691	7,691	5,210	1.89
Iowa	22,291	....	7,332	7,332	4,985	1.81
Kansas	21,784	....	7,556	7,556	4,970	1.80
Kentucky	31,419	....	7,611	7,611	5,067	1.84
Louisiana	42,670	....	8,089	8,089	5,091	1.85
Maine	16,609	....	7,037	7,037	4,874	1.77
Maryland	42,250	....	7,433	7,433	5,164	1.87
Massachusetts	62,436	....	7,928	7,928	5,218	1.89
Michigan	64,075	....	8,071	8,071	5,471	1.99
Minnesota	35,311	....	7,648	7,648	5,132	1.86
Mississippi	22,081	....	7,330	7,330	4,982	1.81
Missouri	46,952	....	7,673	7,673	5,178	1.88
Montana	15,318	....	7,022	7,022	4,848	1.76
Nebraska	23,656	....	7,518	7,518	4,904	1.78
Nevada	28,386	....	7,311	7,311	4,948	1.80
New Hampshire	16,776	....	7,269	7,269	4,873	1.77
New Jersey	60,811	....	7,785	7,785	5,376	1.95
New Mexico	18,727	....	7,060	7,060	4,915	1.78
New York	298,351	....	8,886	8,886	6,090	2.21
North Carolina	46,381	....	8,248	8,248	5,373	1.95
North Dakota	14,376	....	7,011	7,011	4,827	1.75
Ohio	77,823	....	8,819	8,819	5,562	2.02
Oklahoma	29,974	....	7,587	7,587	5,025	1.82
Oregon	34,820	....	7,358	7,358	5,031	1.83
Pennsylvania	87,671	....	7,927	7,927	5,627	2.04
Rhode Island	16,074	....	7,260	7,260	4,857	1.76
South Carolina	26,284	....	7,382	7,382	5,073	1.84
South Dakota	14,809	....	7,016	7,016	4,837	1.76
Tennessee	32,605	....	8,144	8,144	5,189	1.88
Texas	138,570	....	10,882	10,882	6,335	2.30
Utah	20,308	....	7,313	7,313	4,952	1.80
Vermont	14,326	....	7,010	7,010	4,827	1.75
Virginia	38,185	....	8,670	8,670	5,298	1.92
Washington	45,330	....	7,924	7,924	5,211	1.89
West Virginia	18,289	....	7,056	7,056	4,908	1.78
Wisconsin	37,251	....	7,663	7,663	5,160	1.87
Wyoming	13,934	....	7,006	7,006	4,819	1.75
American Samoa	4,279	....	2,331	2,331	1,599	0.58
Guam	4,706	....	2,335	2,335	1,605	0.58
Northern Mariana Islands	4,333	....	2,331	2,331	1,599	0.58
Puerto Rico	25,169	....	7,136	7,136	5,050	1.83
Freely Associated States	....	....	....	....	1,602	0.58
Virgin Islands	4,612	....	2,333	2,333	....	....
Indian Tribes	....	....	....	....	....	....
Undistributed	....	....	....	....	....	....
Marshall Island	50	....	....	....	....	....
Federated States of Micronesia	50	....	....	....	....	....
Total	**2,518,763**	....	**412,929**	[1] **412,929**	[1] **275,560**	[2] **100.00**

[1] FY 2006–2007 amounts do not include funds subject to risk and threat analysis.
[2] Excludes undistributed obligations.

Table 8–27. Public Housing Operating Fund (14.850)

(obligations in thousands of dollars)

State or Territory	FY 2005 Actual	Estimated FY 2006 obligations from:			FY 2007 (estimated)	FY 2007 Percentage of distributed total
		Previous authority	New authority	Total		
Alabama	69,609	35	102,015	102,050	101,562	2.85
Alaska	4,062	2	5,953	5,955	5,927	0.17
Arizona	14,454	7	21,183	21,190	21,089	0.59
Arkansas	8,084	4	11,847	11,851	11,795	0.33
California	67,763	34	99,310	99,344	98,869	2.77
Colorado	15,558	8	22,801	22,809	22,700	0.64
Connecticut	25,101	13	36,787	36,800	36,623	1.03
Delaware	6,636	3	9,725	9,728	9,682	0.27
District of Columbia	10,833	5	15,876	15,881	15,806	0.44
Florida	49,078	25	71,926	71,951	71,607	2.01
Georgia	65,101	33	95,409	95,442	94,985	2.67
Hawaii	5,459	3	8,000	8,003	7,965	0.22
Idaho	536	*	786	786	782	0.02
Illinois	207,929	104	304,730	304,834	303,376	8.51
Indiana	28,815	14	42,230	42,244	42,042	1.18
Iowa	3,168	2	4,643	4,645	4,622	0.13
Kansas	11,984	6	17,563	17,569	17,485	0.49
Kentucky	31,176	16	45,690	45,706	45,487	1.28
Louisiana	20,204	10	29,610	29,620	29,478	0.83
Maine	4,998	3	7,325	7,328	7,292	0.20
Maryland	35,262	18	51,678	51,696	51,448	1.44
Massachusetts	74,499	37	109,182	109,219	108,697	3.05
Michigan	28,478	14	41,736	41,750	41,550	1.17
Minnesota	19,788	10	29,000	29,010	28,871	0.81
Mississippi	16,627	8	24,368	24,376	24,259	0.68
Missouri	21,037	11	30,831	30,842	30,694	0.86
Montana	2,504	1	3,670	3,671	3,653	0.10
Nebraska	9,549	5	13,995	14,000	13,932	0.39
Nevada	4,743	2	6,951	6,953	6,920	0.19
New Hampshire	3,373	2	4,943	4,945	4,921	0.14
New Jersey	108,603	54	159,163	159,217	158,456	4.45
New Mexico	4,155	2	6,089	6,091	6,062	0.17
New York	783,859	393	1,148,783	1,149,176	1,143,678	32.09
North Carolina	58,751	29	86,102	86,131	85,720	2.41
North Dakota	1,932	1	2,831	2,832	2,819	0.08
Ohio	116,812	59	171,194	171,253	170,433	4.78
Oklahoma	17,534	9	25,697	25,706	25,583	0.72
Oregon	9,363	5	13,722	13,727	13,661	0.38
Pennsylvania	174,721	92	256,062	256,154	254,924	7.15
Rhode Island	13,758	7	20,163	20,170	20,073	0.56
South Carolina	15,877	8	23,269	23,277	23,165	0.65
South Dakota	1,581	1	2,317	2,318	2,307	0.06
Tennessee	44,403	22	65,075	65,097	64,786	1.82
Texas	72,547	36	106,321	106,357	105,849	2.97
Utah	2,033	1	2,979	2,980	2,966	0.08
Vermont	1,519	1	2,226	2,227	2,216	0.06
Virginia	29,736	15	43,580	43,595	43,386	1.22
Washington	14,358	7	21,042	21,049	20,949	0.59
West Virginia	9,939	5	14,566	14,571	14,501	0.41
Wisconsin	16,299	8	23,887	23,895	23,781	0.67
Wyoming	849	....	1,244	1,244	1,239	0.03
American Samoa	....	....	....	....	....	....
Guam	795	....	1,165	1,165	1,160	0.03
Northern Mariana Islands	....	....	....	....	....	....
Puerto Rico	48,324	24	70,823	70,847	70,506	1.98
Freely Associated States	....	....	....	....	....	....
Virgin Islands	17,698	9	25,937	25,946	25,821	0.72
Indian Tribes	....	....	....	....	....	....
Undistributed	....	....	....	....	....	....
Other (DOJ Anti-Drug)	7,936	....	....	....	....	....
Voluntary Graduation Bonus	....	....	....	....	9,900	0.28
Asset-Based Management Trust Fund	....	....	....	....	5,940	0.17
Total	**2,439,790**	**1,223**	**3,564,000**	**3,565,223**	[1] **3,564,000**	[2] **100.00**

* $500 or less or 0.005 percent or less.
[1] FY 2007 amounts are not yet updated for the new allocation formula.
[2] Excludes undistributed obligations.

Table 8–28. Housing Choice Vouchers (14.871)

(obligations in thousands of dollars)

State or Territory	FY 2005 Actual	Estimated FY 2006 obligations from:			FY 2007 (estimated)	FY 2007 Percentage of distributed total
		Previous authority	New authority	Total		
Alabama	129,016	787	182,564	183,351	147,504	0.93
Alaska	25,905	158	28,820	28,978	29,609	0.19
Arizona	126,567	772	140,809	141,581	144,664	0.91
Arkansas	84,758	517	94,296	94,813	96,877	0.61
California	2,571,281	15,693	2,860,615	2,876,308	2,938,939	18.55
Colorado	193,845	1,183	215,658	216,841	221,562	1.40
Connecticut	268,862	1,641	299,116	300,757	307,306	1.94
Delaware	28,199	172	31,373	31,545	32,232	0.20
District of Columbia	111,670	682	124,235	124,917	127,637	0.81
Florida	590,349	3,603	695,808	699,411	674,760	4.26
Georgia	348,668	2,128	387,902	390,030	398,523	2.52
Hawaii	76,791	469	85,432	85,901	87,771	0.55
Idaho	30,308	185	33,718	33,903	34,642	0.22
Illinois	738,154	4,505	821,215	825,720	843,699	5.33
Indiana	177,226	1,082	197,168	198,250	202,567	1.28
Iowa	82,419	503	91,693	92,196	94,204	0.59
Kansas	51,279	313	57,049	57,362	58,611	0.37
Kentucky	136,423	833	151,774	152,607	155,930	0.98
Louisiana	178,439	1,089	354,638	355,727	203,953	1.29
Maine	64,095	391	71,307	71,698	73,259	0.46
Maryland	299,542	1,828	333,248	335,076	342,372	2.16
Massachusetts	681,814	4,161	758,535	762,697	779,304	4.92
Michigan	265,488	1,620	295,362	296,983	303,449	1.92
Minnesota	190,938	1,165	212,423	213,589	218,239	1.38
Mississippi	80,470	491	128,555	129,046	91,976	0.58
Missouri	197,304	1,204	219,506	220,710	225,516	1.42
Montana	25,817	158	28,722	28,880	29,509	0.19
Nebraska	52,601	321	58,520	58,841	60,122	0.38
Nevada	85,337	521	94,940	95,460	97,539	0.62
New Hampshire	61,718	377	68,663	69,040	70,543	0.45
New Jersey	523,844	3,197	582,790	585,987	598,747	3.78
New Mexico	64,499	394	71,757	72,151	73,722	0.47
New York	1,637,494	9,994	1,821,753	1,831,747	1,871,633	11.82
North Carolina	277,232	1,692	308,428	310,120	316,873	2.00
North Dakota	26,316	161	29,277	29,438	30,078	0.19
Ohio	453,837	2,770	504,905	507,674	518,729	3.27
Oklahoma	108,644	663	120,870	121,533	124,179	0.78
Oregon	167,470	1,022	186,314	187,336	191,416	1.21
Pennsylvania	433,626	2,646	482,420	485,067	495,629	3.13
Rhode Island	56,500	345	62,858	63,203	64,579	0.41
South Carolina	109,364	667	121,670	122,338	125,002	0.79
South Dakota	23,040	141	25,633	25,773	26,334	0.17
Tennessee	152,464	931	169,620	170,550	174,264	1.10
Texas	829,384	5,062	1,039,800	1,044,862	947,974	5.98
Utah	54,680	334	60,833	61,167	62,499	0.39
Vermont	32,141	196	35,758	35,954	36,737	0.23
Virginia	284,111	1,734	316,081	317,815	324,735	2.05
Washington	291,261	1,778	324,035	325,812	332,907	2.10
West Virginia	53,468	326	59,485	59,811	61,113	0.39
Wisconsin	125,070	763	139,143	139,906	142,953	0.90
Wyoming	9,204	56	10,240	10,296	10,520	0.07
American Samoa	....	....	....	....	....	....
Guam	28,377	173	31,571	31,744	32,435	0.20
Northern Mariana Islands	2,885	18	3,209	3,227	3,297	0.02
Puerto Rico	144,836	884	161,134	162,018	165,546	1.05
Freely Associated States	....	....	....	....	....	....
Virgin Islands	8,208	50	9,132	9,182	9,382	0.06
Indian Tribes	....	....	....	....	....	....
Undistributed	....	....	....	....	....	....
Working Capital Fund	2,881	....	5,841	5,841	5,900	0.04
Total	**13,856,120**	**84,548**	**15,808,219**	**15,892,767**	**15,840,000**	[1] **100.00**

[1] Excludes undistributed obligations.

Table 8–29. Public Housing Capital Fund (14.872)

(obligations in thousands of dollars)

State or Territory	FY 2005 Actual	Estimated FY 2006 obligations from: Previous authority	New authority	Total	FY 2007 (estimated)	FY 2007 Percentage of distributed total
Alabama	73,621	9,277	60,989	70,266	62,748	2.88
Alaska	2,941	371	2,436	2,807	2,507	0.12
Arizona	22,892	2,885	18,964	21,849	19,511	0.90
Arkansas	11,250	1,418	9,320	10,738	9,588	0.44
California	103,240	13,009	85,526	98,535	87,992	4.04
Colorado	14,877	1,875	12,324	14,199	12,680	0.58
Connecticut	33,302	4,196	27,588	31,784	28,383	1.30
Delaware	5,552	700	4,599	5,299	4,732	0.22
District of Columbia	34,120	4,299	28,266	32,565	29,081	1.34
Florida	104,184	13,128	86,308	99,436	88,797	4.08
Georgia	93,165	11,739	77,180	88,919	79,405	3.65
Hawaii	13,579	1,711	11,249	12,960	11,573	0.53
Idaho	1,176	148	974	1,122	1,002	0.05
Illinois	186,371	23,484	154,393	177,877	158,845	7.29
Indiana	32,631	4,112	27,032	31,144	27,812	1.28
Iowa	6,253	788	5,180	5,968	5,329	0.24
Kansas	13,200	1,663	10,935	12,598	11,250	0.52
Kentucky	44,791	5,644	37,106	42,750	38,176	1.75
Louisiana	55,422	6,984	45,913	52,897	47,236	2.17
Maine	7,097	894	5,879	6,773	6,049	0.28
Maryland	51,847	6,533	42,951	49,484	44,189	2.03
Massachusetts	67,474	8,502	55,897	64,399	57,508	2.64
Michigan	49,159	6,194	40,724	46,918	41,898	1.92
Minnesota	37,083	4,673	30,720	35,393	31,606	1.45
Mississippi	24,708	3,113	20,469	23,582	21,059	0.97
Missouri	35,759	4,506	29,623	34,129	30,478	1.40
Montana	3,798	479	3,146	3,625	3,237	0.15
Nebraska	10,283	1,296	8,519	9,815	8,764	0.40
Nevada	7,869	992	6,519	7,511	6,707	0.31
New Hampshire	6,143	774	5,089	5,863	5,236	0.24
New Jersey	90,751	11,435	75,180	86,615	77,348	3.55
New Mexico	8,101	1,021	6,711	7,732	6,905	0.32
New York	434,906	54,801	360,285	415,086	370,673	17.02
North Carolina	63,667	8,023	52,743	60,766	54,264	2.49
North Dakota	8,347	1,052	6,915	7,967	7,114	0.33
Ohio	104,575	13,177	86,632	99,809	89,130	4.09
Oklahoma	20,454	2,577	16,944	19,521	17,433	0.80
Oregon	11,825	1,490	9,796	11,286	10,079	0.46
Pennsylvania	180,156	22,701	149,245	171,946	153,548	7.05
Rhode Island	16,344	2,059	13,540	15,599	13,930	0.64
South Carolina	28,782	3,627	23,844	27,471	24,531	1.13
South Dakota	2,210	278	1,831	2,109	1,884	0.09
Tennessee	64,118	8,079	53,117	61,196	54,648	2.51
Texas	100,123	12,616	82,944	95,560	85,335	3.92
Utah	3,440	433	2,850	3,283	2,932	0.13
Vermont	2,529	319	2,095	2,414	2,155	0.10
Virginia	42,766	5,389	35,428	40,817	36,450	1.67
Washington	33,673	4,243	27,895	32,138	28,700	1.32
West Virginia	10,747	1,354	8,903	10,257	9,160	0.42
Wisconsin	21,635	2,726	17,923	20,649	18,440	0.85
Wyoming	1,116	141	925	1,066	951	0.04
American Samoa	....	....	....	....	....	....
Guam	2,033	256	1,684	1,940	1,733	0.08
Northern Mariana Islands	....	....	....	....	....	....
Puerto Rico	144,504	18,209	119,710	137,919	123,160	5.65
Freely Associated States	....	....	....	....	....	....
Virgin Islands	4,833	609	4,004	4,613	4,119	0.19
Indian Tribes	....	....	....	....	....	....
Undistributed	....	....	....	....	....	....
Total	**2,555,422**	**322,002**	**2,116,962**	**2,438,964**	**2,178,000**	[1] **100.00**

[1] Excludes undistributed obligations.

Table 8–30. Community Development Block Grants (14.218, 14.219, 14.228)

(obligations in thousands of dollars)

State or Territory	FY 2005 Actual	Estimated FY 2006 obligations from: Previous authority	New authority	Total	FY 2007 (estimated)	FY 2007 Percentage of distributed total
Alabama	55,121	....	49,685	49,685	39,808	1.31
Alaska	5,268	....	4,748	4,748	3,804	0.13
Arizona	60,444	....	54,643	54,643	43,780	1.44
Arkansas	30,657	....	27,646	27,646	22,150	0.73
California	525,106	....	472,940	472,940	378,922	12.50
Colorado	42,709	....	38,552	38,552	30,888	1.02
Connecticut	46,571	....	41,989	41,989	33,642	1.11
Delaware	8,078	....	7,265	7,265	5,820	0.19
District of Columbia	21,317	....	19,274	19,274	15,442	0.51
Florida	179,685	....	162,226	162,226	129,976	4.29
Georgia	92,696	....	83,679	83,679	67,044	2.21
Hawaii	17,081	....	15,360	15,360	12,307	0.41
Idaho	13,486	....	12,190	12,190	9,767	0.32
Illinois	196,215	....	177,014	177,014	141,825	4.68
Indiana	78,262	....	70,667	70,667	56,619	1.87
Iowa	45,885	....	41,409	41,409	33,177	1.09
Kansas	31,114	....	28,065	28,065	22,485	0.74
Kentucky	50,977	....	45,900	45,900	36,776	1.21
Louisiana	69,448	....	62,597	62,597	50,153	1.65
Maine	22,219	....	20,034	20,034	16,051	0.53
Maryland	62,822	....	56,184	56,184	45,015	1.48
Massachusetts	123,017	....	111,089	111,089	89,005	2.94
Michigan	147,609	....	132,829	132,829	106,423	3.51
Minnesota	64,979	....	58,533	58,533	46,897	1.55
Mississippi	39,235	....	35,358	35,358	28,329	0.93
Missouri	76,153	....	68,149	68,149	54,601	1.80
Montana	10,236	....	9,234	9,234	7,398	0.24
Nebraska	21,740	....	19,561	19,561	15,673	0.52
Nevada	22,414	....	20,330	20,330	16,289	0.54
New Hampshire	14,703	....	13,274	13,274	10,635	0.35
New Jersey	112,983	....	101,729	101,729	81,506	2.69
New Mexico	23,425	....	21,139	21,139	16,937	0.56
New York	393,506	....	353,271	353,271	283,042	9.34
North Carolina	79,305	....	71,585	71,585	57,354	1.89
North Dakota	7,093	....	6,388	6,388	5,118	0.17
Ohio	181,179	....	163,276	163,276	130,817	4.31
Oklahoma	33,883	....	30,491	30,491	24,429	0.81
Oregon	40,835	....	36,899	36,899	29,564	0.98
Pennsylvania	248,858	....	223,899	223,899	179,389	5.92
Rhode Island	19,164	....	17,247	17,247	13,818	0.46
South Carolina	43,346	....	39,107	39,107	31,333	1.03
South Dakota	8,889	....	8,021	8,021	6,427	0.21
Tennessee	55,911	....	50,415	50,415	40,392	1.33
Texas	285,549	....	258,899	258,899	207,431	6.84
Utah	22,837	....	20,633	20,633	16,531	0.55
Vermont	9,267	....	8,366	8,366	6,703	0.22
Virginia	68,542	....	61,716	61,716	49,447	1.63
Washington	68,791	....	62,092	62,092	49,748	1.64
West Virginia	28,057	....	25,271	25,271	20,247	0.67
Wisconsin	74,409	....	67,184	67,184	53,828	1.78
Wyoming	4,703	....	4,232	4,232	3,390	0.11
American Samoa	1,020	....	1,018	1,018	1,018	0.03
Guam	2,757	....	2,751	2,751	2,751	0.09
Northern Mariana Islands	1,233	....	1,230	1,230	1,230	0.04
Puerto Rico	124,111	....	111,704	111,704	89,498	2.95
Freely Associated States	....	....	....	....	....	....
Virgin Islands	1,934	....	1,930	1,930	1,930	0.06
Indian Tribes	....	....	....	....	....	....
Undistributed	....	....	....	....	....	....
Set-asides	584,947	....	466,884	466,884	[1] 57,420	1.89
Total [2]	**4,701,782**	....	**4,177,800**	**4,177,800**	[3] **3,032,000**	[4] **100.00**

[1] FY 2007 funds are the Indian Community Development Block Grant Program.
[2] Includes Entitlement Grants, Small Cities Program, and State's Program.
[3] A set-aside (to be determined) will be proposed to be used for bonus funds.
[4] Excludes undistributed obligations.

Table 8–31. HOME Investment Partnerships Program (14.239)

(obligations in thousands of dollars)

State or Territory	FY 2005 Actual	Estimated FY 2006 obligations from:			FY 2007 (estimated)	FY 2007 Percentage of distributed total
		Previous authority	New authority	Total		
Alabama	25,868	....	24,131	24,131	26,968	1.41
Alaska	4,184	....	4,056	4,056	4,515	0.24
Arizona	26,613	....	24,694	24,694	27,714	1.45
Arkansas	16,328	....	15,203	15,203	16,989	0.89
California	266,522	....	247,356	247,356	275,030	14.35
Colorado	22,855	....	21,080	21,080	23,777	1.24
Connecticut	21,295	....	19,726	19,726	22,098	1.15
Delaware	5,088	....	4,905	4,905	5,435	0.28
District of Columbia	9,220	....	8,661	8,661	9,622	0.50
Florida	82,937	....	77,411	77,411	86,754	4.53
Georgia	44,160	....	41,133	41,133	46,167	2.41
Hawaii	7,832	....	7,410	7,410	8,310	0.43
Idaho	7,057	....	6,575	6,575	7,337	0.38
Illinois	77,508	....	71,877	71,877	80,390	4.19
Indiana	31,171	....	28,930	28,930	32,514	1.70
Iowa	15,438	....	14,313	14,313	16,048	0.84
Kansas	13,886	....	12,840	12,840	14,456	0.75
Kentucky	25,487	....	23,670	23,670	26,436	1.38
Louisiana	31,906	....	29,558	29,558	32,861	1.71
Maine	8,609	....	7,994	7,994	8,904	0.46
Maryland	26,065	....	24,023	24,023	27,091	1.41
Massachusetts	48,900	....	45,036	45,036	50,278	2.62
Michigan	52,668	....	48,574	48,574	54,337	2.84
Minnesota	23,348	....	21,620	21,620	24,309	1.27
Mississippi	17,575	....	16,393	16,393	18,216	0.95
Missouri	31,684	....	29,469	29,469	33,060	1.72
Montana	6,330	....	5,891	5,891	6,567	0.34
Nebraska	9,339	....	8,609	8,609	9,727	0.51
Nevada	12,252	....	11,491	11,491	12,883	0.67
New Hampshire	6,655	....	6,173	6,173	6,919	0.36
New Jersey	50,417	....	46,523	46,523	51,975	2.71
New Mexico	11,231	....	10,480	10,480	11,661	0.61
New York	207,164	....	192,144	192,144	212,808	11.10
North Carolina	41,507	....	38,254	38,254	43,037	2.25
North Dakota	3,696	....	3,595	3,595	4,048	0.21
Ohio	68,637	....	63,613	63,613	71,298	3.72
Oklahoma	20,927	....	19,385	19,385	21,708	1.13
Oregon	22,326	....	20,709	20,709	23,211	1.21
Pennsylvania	77,375	....	71,430	71,430	79,631	4.15
Rhode Island	9,720	....	9,044	9,044	10,105	0.53
South Carolina	20,436	....	18,797	18,797	21,069	1.10
South Dakota	4,385	....	4,058	4,058	4,560	0.24
Tennessee	31,778	....	29,468	29,468	33,048	1.72
Texas	121,892	....	112,372	112,372	125,977	6.57
Utah	9,601	....	8,872	8,872	9,956	0.52
Vermont	4,343	....	4,051	4,051	4,503	0.23
Virginia	35,105	....	32,504	32,504	36,532	1.91
Washington	35,284	....	32,641	32,641	36,703	1.91
West Virginia	13,388	....	12,473	12,473	13,800	0.72
Wisconsin	29,261	....	26,918	26,918	30,326	1.58
Wyoming	3,586	....	3,543	3,543	3,929	0.21
American Samoa	337	....	315	315	339	0.02
Guam	1,393	....	1,303	1,303	1,399	0.07
Northern Mariana Islands	642	....	600	600	645	0.03
Puerto Rico	33,722	....	31,722	31,722	34,049	1.78
Freely Associated States	....	....	....	....	....	....
Virgin Islands	1,245	....	1,164	1,164	1,250	0.07
Indian Tribes	....	....	....	....	....	....
Undistributed	....	....	....	....	....	....
Technical Assistance & Working Capital Fund Transfer	[1] 61,504	....	52,470	[1] 52,470	13,365	0.70
Total	**1,899,680**	....	**1,757,250**	**1,757,250**	**1,916,640**	[2] **100.00**

[1] FY 2005–2006 also include Housing Counseling.
[2] Excludes undistributed obligations.

Table 8–32. Airport Improvement Program (20.106)

(obligations in thousands of dollars)

State or Territory	FY 2005 Actual	Estimated FY 2006 obligations from:			FY 2007 (estimated)	FY 2007 Percentage of distributed total
		Previous authority	New authority	Total		
Alabama	[1] 60,134		56,089	56,089	43,359	1.64
Alaska	202,937		195,153	195,153	150,862	5.70
Arizona	82,367		79,208	79,208	61,232	2.31
Arkansas	44,763		43,046	43,046	33,277	1.26
California	289,846		278,728	278,728	215,470	8.14
Colorado	92,572		89,021	89,021	68,818	2.60
Connecticut	4,973		4,782	4,782	3,697	0.14
Delaware	6,762		6,503	6,503	5,027	0.19
District of Columbia	295		284	284	219	0.01
Florida	[1] 195,112	[1] 9	165,834	165,843	128,198	4.84
Georgia	100,842		96,974	96,974	74,965	2.83
Hawaii	56,025		53,876	53,876	41,648	1.57
Idaho	29,724		28,583	28,583	22,096	0.83
Illinois	124,207		119,442	119,442	92,335	3.49
Indiana	79,772		76,712	76,712	59,302	2.24
Iowa	53,385		51,337	51,337	39,686	1.50
Kansas	32,134		30,902	30,902	23,888	0.90
Kentucky	[1] 92,178		88,535	88,535	68,442	2.59
Louisiana	75,970		73,056	73,056	56,475	2.13
Maine	18,866		18,142	18,142	14,025	0.53
Maryland	63,440		61,006	61,006	47,161	1.78
Massachusetts	52,064		50,067	50,067	38,704	1.46
Michigan	104,508		100,499	100,499	77,691	2.93
Minnesota	78,707		75,688	75,688	58,511	2.21
Mississippi	[1] 46,774		44,887	44,887	34,700	1.31
Missouri	88,149		84,768	84,768	65,530	2.48
Montana	41,360		39,774	39,774	30,747	1.16
Nebraska	25,742		24,755	24,755	19,137	0.72
Nevada	64,025		61,569	61,569	47,596	1.80
New Hampshire	21,541		20,715	20,715	16,013	0.60
New Jersey	49,216		47,328	47,328	36,587	1.38
New Mexico	17,245		16,584	16,584	12,820	0.48
New York	145,934		140,337	140,337	108,487	4.10
North Carolina	[1] 76,021		73,018	73,018	56,446	2.13
North Dakota	24,313		23,380	23,380	18,074	0.68
Ohio	87,351		84,000	84,000	64,936	2.45
Oklahoma	44,896		43,174	43,174	33,376	1.26
Oregon	39,212		37,708	37,708	29,150	1.10
Pennsylvania	108,755		104,584	104,584	80,848	3.05
Rhode Island	20,271		19,494	19,494	15,070	0.57
South Carolina	35,556		34,192	34,192	26,432	1.00
South Dakota	23,668		22,760	22,760	17,594	0.66
Tennessee	69,104		66,453	66,453	51,441	1.94
Texas	234,264		225,278	225,278	174,151	6.58
Utah	34,148		32,838	32,838	25,385	0.96
Vermont	11,215		10,784	10,784	8,337	0.31
Virginia	49,021		47,141	47,141	36,442	1.38
Washington	90,653		87,176	87,176	67,391	2.55
West Virginia	29,635		28,498	28,498	22,031	0.83
Wisconsin	[2] 60,946		58,500	58,500	45,224	1.71
Wyoming	25,245		24,276	24,276	18,767	0.71
American Samoa	13,080		12,580	12,580	9,725	0.37
Guam	10,487		10,083	10,083	7,796	0.29
Northern Mariana Islands	41,864		40,260	40,260	31,123	1.18
Puerto Rico	[1] 9,465		8,890	8,890	6,800	0.26
Freely Associated States						
Virgin Islands	5,266		5,064	5,064	3,915	0.15
Indian Tribes						
Undistributed [3]	87,294		90,185	90,185	102,841	
Total	**3,673,299**	**9**	**3,514,500**	**3,514,509**	**2,750,000**	[4] **100.00**

[1] Includes Emergency Assistance to Airports.
[2] Includes Emergency Response Fund.
[3] Includes Personnel and Related Expenses, Small Community Air Service, Airport Technology Research, Airport Cooperative Research Program, and Reimbursable.
[4] Excludes undistributed obligations.

Table 8–33. Highway Planning and Construction (20.205)

(obligations in thousands of dollars)

State or Territory	FY 2005 Actual	Estimated FY 2006 obligations from: Previous authority	New authority	Total	FY 2007 (estimated)	FY 2007 Percentage of distributed total
Alabama	688,151	....	669,352	669,352	704,215	1.98
Alaska	379,930	....	424,964	424,964	447,098	1.26
Arizona	540,183	....	597,599	597,599	628,725	1.77
Arkansas	360,297	....	431,045	431,045	453,495	1.28
California	2,540,025	....	2,965,512	2,965,512	3,119,968	8.79
Colorado	389,444	....	436,620	436,620	459,361	1.29
Connecticut	446,224	....	469,815	469,815	494,285	1.39
Delaware	116,614	....	144,321	144,321	151,838	0.43
District of Columbia	126,557	....	143,545	143,545	151,022	0.43
Florida	2,074,154	....	1,585,130	1,585,130	1,667,690	4.70
Georgia	1,140,079	....	1,150,152	1,150,152	1,210,057	3.41
Hawaii	144,447	....	163,516	163,516	172,032	0.48
Idaho	241,246	....	254,107	254,107	267,341	0.75
Illinois	911,457	....	1,149,882	1,149,882	1,209,773	3.41
Indiana	699,623	....	808,852	808,852	850,981	2.40
Iowa	327,902	....	381,718	381,718	401,599	1.13
Kansas	334,078	....	371,469	371,469	390,817	1.10
Kentucky	436,127	....	584,869	584,869	615,331	1.73
Louisiana	519,391	....	520,984	520,984	548,119	1.54
Maine	138,605	....	182,853	182,853	192,376	0.54
Maryland	500,382	....	536,232	536,232	564,162	1.59
Massachusetts	550,905	....	584,796	584,796	615,254	1.73
Michigan	962,760	....	1,014,325	1,014,325	1,067,155	3.01
Minnesota	410,684	....	553,222	553,222	582,037	1.64
Mississippi	404,222	....	407,797	407,797	429,036	1.21
Missouri	716,104	....	782,232	782,232	822,973	2.32
Montana	312,358	....	337,213	337,213	354,776	1.00
Nebraska	216,152	....	258,345	258,345	271,802	0.77
Nevada	220,871	....	240,325	240,325	252,841	0.71
New Hampshire	148,345	....	162,975	162,975	171,464	0.48
New Jersey	775,572	....	867,850	867,850	913,051	2.57
New Mexico	268,265	....	318,988	318,988	335,602	0.95
New York	1,508,471	....	1,627,004	1,627,004	1,711,744	4.82
North Carolina	866,620	....	927,654	927,654	975,972	2.75
North Dakota	216,396	....	217,464	217,464	228,791	0.64
Ohio	1,176,520	....	1,185,678	1,185,678	1,247,433	3.51
Oklahoma	583,217	....	470,578	470,578	495,087	1.39
Oregon	315,794	....	385,992	385,992	406,095	1.14
Pennsylvania	1,352,520	....	1,588,241	1,588,241	1,670,962	4.71
Rhode Island	157,430	....	187,912	187,912	197,700	0.56
South Carolina	524,970	....	529,987	529,987	557,592	1.57
South Dakota	203,701	....	236,477	236,477	248,793	0.70
Tennessee	646,151	....	725,080	725,080	762,845	2.15
Texas	2,596,328	....	2,643,137	2,643,137	2,780,802	7.83
Utah	217,735	....	260,767	260,767	274,348	0.77
Vermont	121,771	....	160,240	160,240	168,586	0.47
Virginia	682,875	....	855,897	855,897	900,475	2.54
Washington	549,341	....	570,316	570,316	600,020	1.69
West Virginia	465,122	....	370,003	370,003	389,275	1.10
Wisconsin	573,737	....	652,997	652,997	687,007	1.94
Wyoming	200,808	....	220,725	220,725	232,221	0.65
American Samoa	12,231	....	11,765	11,765	12,378	0.03
Guam	11,688	....	11,011	11,011	11,584	0.03
Northern Mariana Islands	2,815	....	1,407	1,407	1,481	*
Puerto Rico	92,857	....	83,700	83,700	88,060	0.25
Freely Associated States	....	....	....	....	....	....
Virgin Islands	19,539	....	22,889	22,889	24,081	0.07
Indian Tribes	214,663	....	292,868	292,868	308,122	0.87
Undistributed	1,834,875	....	4,205,307	4,205,307	4,424,336	....
Total	**33,189,330**	....	[1] **37,945,701**	[1] **37,945,701**	**39,922,066**	[2] **100.00**

* $500 or less or 0.005 percent or less.

[1] Distribution of estimated FY 2006 obligations from previous and new authority was not available at the time of publication.

[2] Excludes undistributed obligations.

Table 8–34. Capital Investment Grants—Fixed Guideway Modernization (Section 5309) (20.500)

(obligations in thousands of dollars)

State or Territory	FY 2005 Actual	Estimated FY 2006 obligations from: Previous authority	New authority	Total	FY 2007 (estimated)	FY 2007 Percentage of distributed total
Alabama	....	....	....	....	....	....
Alaska	2,458	....	12,021	12,021	19,788	1.14
Arizona	2,300	1,144	2,236	3,380	3,603	0.21
Arkansas	....	....	....	....	....	....
California	203,822	8,059	144,541	152,600	229,773	13.28
Colorado	2,747	529	3,166	3,694	5,120	0.30
Connecticut	11,854	23,454	34,628	58,082	53,168	3.07
Delaware	....	....	....	....	....	....
District of Columbia	58,419	2,599	50,573	53,172	81,608	4.72
Florida	8,776	6,950	18,480	25,430	29,766	1.72
Georgia	12,680	9,367	25,613	34,980	41,274	2.39
Hawaii	1,920	733	1,077	1,810	1,743	0.10
Idaho	....	....	....	....	....	....
Illinois	105,849	14,819	117,342	132,160	181,367	10.49
Indiana	5,696	349	7,698	8,047	11,959	0.69
Iowa	....	....	....	....	....	....
Kansas	....	....	....	....	....	....
Kentucky	....	....	....	....	....	....
Louisiana	4,831	534	2,625	3,158	4,029	0.23
Maine	....	....	....	....	....	....
Maryland	35,514	24,401	25,541	49,942	40,152	2.32
Massachusetts	58,108	41,392	67,271	108,663	104,274	6.03
Michigan	....	450	300	749	477	0.03
Minnesota	....	5,988	5,867	11,855	9,433	0.55
Mississippi	....	....	....	....	....	....
Missouri	26	1,996	4,055	6,051	6,520	0.38
Montana	....	....	....	....	....	....
Nebraska	....	....	....	....	....	....
Nevada	....	....	....	....	....	....
New Hampshire	....	....	....	....	....	....
New Jersey	92,631	454	90,475	90,929	139,597	8.07
New Mexico	....	....	....	....	....	....
New York	237,809	64,194	323,304	387,498	500,563	28.94
North Carolina	....	....	....	....	....	....
North Dakota	....	....	....	....	....	....
Ohio	20,992	3,756	15,394	19,150	23,826	1.38
Oklahoma	....	....	....	....	....	....
Oregon	3,953	*	4,080	4,080	6,581	0.38
Pennsylvania	123,693	1,223	85,988	87,211	131,872	7.62
Rhode Island	4,500	648	66	714	105	0.01
South Carolina	....	....	....	....	....	....
South Dakota	....	....	....	....	....	....
Tennessee	211	35	302	337	493	0.03
Texas	5,031	14,708	12,516	27,224	20,286	1.17
Utah	....	....	....	....	....	....
Vermont	....	....	....	....	....	....
Virginia	....	1,578	16,507	18,085	26,621	1.54
Washington	28,009	1,409	21,601	23,009	34,743	2.01
West Virginia	....	475	964	1,439	1,550	0.09
Wisconsin	708	125	960	1,085	1,551	0.09
Wyoming	....	....	....	....	....	....
American Samoa	....	....	....	....	....	....
Guam	....	....	....	....	....	....
Northern Mariana Islands	....	....	....	....	....	....
Puerto Rico	....	1,452	2,029	3,481	3,259	0.19
Freely Associated States	....	....	....	....	....	....
Virgin Islands	....	....	....	....	....	....
Indian Tribes	....	....	....	....	....	....
Undistributed	....	....	....	....	....	....
Oversight	....	....	13,910	13,910	14,480	0.84
Total [1]	**1,032,539**	**232,819**	**1,111,129**	**1,343,948**	**1,729,579**	[2] **100.00**

* $500 or less or 0.005 percent or less.
[1] Includes funding from the Formula and Bus Grants Program (69X8350).
[2] Excludes undistributed obligations.

Table 8–35. Federal Transit Formula Grants and Research (Section 5307) (20.507)

(obligations in thousands of dollars)

State or Territory	FY 2005 Actual	Estimated FY 2006 obligations from: Previous authority	New authority	Total	FY 2007 (estimated)	FY 2007 Percentage of distributed total
Alabama	31,705	17,231	27,067	44,298	48,537	0.79
Alaska	20,064	2,443	21,480	23,924	37,393	0.61
Arizona	77,143	30,237	50,810	81,047	86,304	1.40
Arkansas	14,373	3,052	16,244	19,296	25,520	0.41
California	1,077,836	197,915	515,647	713,562	909,190	14.78
Colorado	77,559	2,905	47,193	50,098	82,169	1.34
Connecticut	49,278	41,172	52,384	93,556	93,242	1.52
Delaware	6,853	4,283	9,285	13,568	15,832	0.26
District of Columbia	148,699	13,654	53,233	66,887	99,628	1.62
Florida	210,007	45,680	164,678	210,358	285,272	4.64
Georgia	156,782	32,133	73,665	105,798	125,130	2.03
Hawaii	33,017	1,314	22,368	23,682	39,217	0.64
Idaho	7,897	1,882	10,259	12,141	16,100	0.26
Illinois	256,828	35,175	191,617	226,792	335,918	5.46
Indiana	49,637	17,990	44,454	62,444	74,743	1.22
Iowa	24,486	4,276	20,420	24,696	34,161	0.56
Kansas	17,212	6,425	16,954	23,379	28,075	0.46
Kentucky	23,671	4,183	27,022	31,205	44,088	0.72
Louisiana	42,416	14,833	35,615	50,448	60,741	0.99
Maine	6,716	3,674	7,993	11,667	13,236	0.22
Maryland	79,302	16,925	82,910	99,835	145,809	2.37
Massachusetts	124,682	46,213	132,145	178,358	234,907	3.82
Michigan	98,059	12,260	76,383	88,643	128,067	2.08
Minnesota	55,900	36,792	47,237	84,029	80,692	1.31
Mississippi	12,479	6,343	15,442	21,786	22,869	0.37
Missouri	64,247	11,866	44,278	56,144	76,924	1.25
Montana	5,996	2,645	9,637	12,282	13,204	0.21
Nebraska	21,812	1,980	12,565	14,546	20,066	0.33
Nevada	21,190	18,910	23,488	42,398	39,249	0.64
New Hampshire	4,806	7,493	7,869	15,363	12,264	0.20
New Jersey	213,290	30,578	213,338	243,916	384,322	6.25
New Mexico	10,260	6,455	15,184	21,640	25,386	0.41
New York	226,661	382,305	486,575	868,881	866,407	14.09
North Carolina	77,258	31,002	53,946	84,948	89,215	1.45
North Dakota	6,312	877	6,520	7,397	9,815	0.16
Ohio	142,336	25,644	94,076	119,720	159,393	2.59
Oklahoma	29,996	5,690	22,126	27,816	38,159	0.62
Oregon	85,687	5,629	38,719	44,347	66,489	1.08
Pennsylvania	320,453	24,718	144,712	169,430	253,189	4.12
Rhode Island	20,398	5,538	14,611	20,149	25,222	0.41
South Carolina	17,613	14,143	24,378	38,521	38,856	0.63
South Dakota	4,122	2,553	7,352	9,905	10,247	0.17
Tennessee	48,902	16,506	38,700	55,205	68,457	1.11
Texas	275,902	60,444	202,736	263,180	350,610	5.70
Utah	33,122	3,002	28,434	31,436	49,062	0.80
Vermont	8,640	1,060	3,969	5,029	5,873	0.10
Virginia	67,316	21,091	58,249	79,340	99,903	1.62
Washington	151,031	20,133	87,578	107,711	156,017	2.54
West Virginia	11,544	1,388	11,116	12,504	17,872	0.29
Wisconsin	79,951	15,225	45,825	61,049	80,589	1.31
Wyoming	3,664	676	5,358	6,034	7,780	0.13
American Samoa	224	128	334	462	430	0.01
Guam	1,029	82	758	840	926	0.02
Northern Mariana Islands	988	....	742	742	1,185	0.02
Puerto Rico	16,840	36,568	40,112	76,680	66,662	1.08
Freely Associated States	....	....	....	....	....	....
Virgin Islands	916	....	850	850	1,367	0.02
Indian Tribes	....	....	....	....	....	....
Undistributed	....	....	....	....	....	....
Oversight	17,168	....	36,631	36,631	47,832	0.78
Total [1]	**4,692,274**	**1,353,317**	**3,543,274**	**4,896,591**	**6,149,810**	[2] **100.00**

[1] Includes Elderly and Persons with Disabilities (CFDA 20.513), Job Access and Reverse Commute (CFDA 20.516), Metropolitan Planning (CFDA 20.505), Rural Transportation Assistance Program (CFDA 20.509), State Planning and Research (CFDA 20.515), Formula Program for Non-Urbanized Areas (CFDA 20.509), and New Freedom Initiative.

[2] Excludes undistributed obligations.

9. INTEGRATING SERVICES WITH INFORMATION TECHNOLOGY

This year, the President is proposing to spend about $64 billion for Information Technology (IT) and associated support services to deliver results for the American people, providing timely and accurate information to citizens and Government decision makers while ensuring security and privacy.

As one of the largest users and acquirers of data, information and supporting technology systems in the world, the United States Government will continue its efforts to strengthen our capabilities in managing technology and information in order to be the world's leader in information technology. Departments and agencies are determined to build upon past success including their experience with enterprise architecture and to apply new principles and methods such as earned value management (EVM) to achieve greater savings, better results and improved customer service levels.

ACHIEVING RESULTS

The Federal Government continues to deliver results through the adoption of electronic government management principles and best practices for the implementation of information technology. Departments and agencies are focused on:

- Improving service levels to citizens and Government decision makers;
- Making better purchasing decisions;
- Securing our systems and data; and
- Reducing duplication and related costs.

With these goals in mind, the Federal departments and agencies are fulfilling the goals of the Clinger-Cohen Act of 1996. This Act also requires the Director of the Office of Management and Budget (OMB) to submit an annual report to the Congress on the results we are achieving from Federal IT spending. This Budget chapter and Table 9–1, "Effectiveness of Agency's IT Management and E-Gov Processes," included on the CD–ROM, fulfill the statutory reporting requirement. Other management guidance provided to Federal departments and agencies is included on Table 9–2, "Management Guidance," and is available at *www.whitehouse.gov/OMB/memoranda.*

Government Performance.—The Federal Government has shown improvement over the last year in achieving the goals specifically included in the President's Management Agenda, the Expanded Electronic Government initiative. For example, each IT investment must have specific performance targets tied to a specific significant benefits for our citizens and performance must be defined, valued and delivered in terms of measurable outcomes.

The Federal departments and agencies continue to improve in their efforts to guarantee success and results for the taxpayer. The Administration continues to monitor the performance of its IT investments. With the release of the FY 2006 President's Budget, there were 342 major projects representing about $15 billion on the "Management Watch List," i.e., those project justifications needing improvement in performance measurement, earned value management or system security. Before the start of the fiscal year, agencies were directed to remedy the shortfalls identified prior to expending funds. The agencies have worked to correct the weaknesses or have put measures in place to monitor the progress of the project. If a project is still on the "Management Watch List," agencies must describe their plans to manage or mitigate risk before undertaking or continuing that project. As of September 30, 2005, 84 percent of the agencies (21 of 25) had acceptable FY 2006 business cases. As a result, from last year's "Management Watch List," only 19 business cases, valued in FY 2006 at $314.5 million from four agencies remain. As of the printing of this budget, 263 of 857 projects valued at $9.9 billion are on the "Management Watch List." These projects still need to address performance measures, implementation of earned value management, security or other issues before obligating funding in FY 2007.

The Report on Information Technology (IT) Spending for the Federal Government (Exhibit 53) located at *www.whitehouse.gov/OMB*, provides details of the Administration's proposed 2007 IT investments. Related documents on IT security and Electronic Government (E-Government) will also be available at *www.whitehouse.gov/OMB* and will be published by March 1, 2006.

Since the Administration's guidance on capital assets has not changed from FY 2005 through FY 2007, investments were studied for trends and potential duplications across Government entities. At about $64 billion, the 2007 Federal IT portfolio represents nearly a 3 percent increase over the FY 2006 President's Budget (see July 2005, Update to the Report on Information Technology (IT) Spending for the Federal Government (Exhibit 53) located at *www.whitehouse.gov/OMB.*) The following represents the highlights:

	FY 2005	FY 2006	FY 2007	Percent Change [1]
Major IT Investments	1,130	1,087	857	–21%
Not Well Planned and Managed [2]	745	358	263	–27%
Well Planned and Managed	385	682	594	–13%

	FY 2005	FY 2006	FY 2007	Percent [1] Change
	(Value in millions)			
Major IT Investments	$32,341	$40,979	$36,999	–10%
Not Well Planned and Managed [2]	$23,863	$16,218	$9,938	–39%
Well Planned and Managed	$8,478	$24,761	$27,061	9%

[1] Change from FY 2006 to FY 2007.
[1] Reflects investments on Management Watch List as well as those rated Unacceptable.

In reviewing the overall IT portfolio, the trend of decreasing major IT investments is attributed to departments' and agencies' efforts to better manage their Capital Planning and Investment Control (CPIC) process in conformance with their enterprise architectures. Although the trend may indicate a problem, the maturing CPIC processes provide for greater oversight and evaluation of the investments achieving and/or addressing intended results by departments' and agencies' Chief Information Officers. This oversight and understanding allows for changes in the IT portfolio to address mission priorities, consolidation and elimination of redundant investments.

The Administration continues its oversight to ensure the American taxpayer's dollars are being invested wisely. This oversight includes analysis of overlapping or duplicative IT investments as well as high risk projects. Avoiding duplication is one of the four principal criteria agencies must report on high risk projects as included in OMB's Memorandum M–05–23, "Improving Information Technology Project Planning and Execution," dated August 4, 2005.

The other three criteria are:

- establishing and validating baselines with clear goals;
- managing and measuring projects to within 10% of baseline goals using earned value management; and
- having a qualified project manager.

Agencies work with OMB to identify high-risk projects (those requiring special attention from oversight authorities and the highest level of agency management) and report on them quarterly to OMB. As a result, oversight authorities and agency management now have data on how these projects are performing at least quarterly to ensure improved execution and performance. OMB is working with the agencies to implement corrective actions in cases where a project did not meet one or more of the four principal criteria.

When duplication across Federal agencies has been identified, the Administration has an ongoing process, through inter-agency taskforces, to bring together the appropriate agencies and help them to consider broad-based approaches to promote inter-agency data sharing and cooperation in building common solutions, rather than maintaining separate investments. Upon migration to common, Government-wide solutions, agencies will shut down redundant systems which will not only save money but also free-up resources for agencies to better focus on achieving their missions. These inter-agency taskforces focus on the agency Lines of Business (LoB) rather than a specific technology or investment. In FY 2006, there was significant progress made on six LoB efforts. These are:

- Case Management
- Federal Health Architecture
- Financial Management
- Human Resources Management
- Grants Management
- Information System Security

Case Management.—The Department of Justice with the Department of Homeland Security developed the business and architectural solution for sharing investigative case management information. The work will continue this year under the leadership of the Department of Justice to ensure the solution is applicable Government-wide to improve the effectiveness and efficiency of sharing information for law enforcement, investigation and civil and criminal litigation case management.

Federal Health Architecture (FHA).—The Department of Health and Human Services (HHS) continues to work through the Office of the National Coordinator for Health Information Technology (ONCHIT). In October 2005, the American Health Information Community (AHIC) was established by the Secretary of HHS. The AHIC comprises representation from the private sector, industry, State and local government, and the Federal Government, and will advise the Secretary of HHS on health information technology issues. A total of $5.5 billion for health information technology is being requested for FY07, a slight increase from the FY2006 request of $5.4 billion.

Throughout the coming year, the Administration will continue to focus on the improvement of the quality and efficiency of health care by ensuring the appropriate steps are taken to eventually enable Federal health information technology systems to share health information amongst Federal agencies, with the private sector, and with other governmental entities. Specifically, the Administration will focus on the areas of standards implementation, additional standards development and harmonization, alignment of agency investments, and increased interoperability.

Financial Management (FM) and Human Resources Management (HR).—As part of the FY 2006 budget process, OMB designated the following agencies as LoB service provider candidates, capable of entering into competitions for servicing interested Federal agencies:

- FM: GSA, Interior, Treasury, and Transportation
- HR: USDA, Interior, Treasury, HHS, and DOD

This year, these departments and agencies will focus on agency migrations and on fulfilling the promise of service providers to realize economies of scale and improved service delivery to customer agencies. Agencies will continue to use their existing legacy systems for the remainder of their system life cycle. At the point when an agency needs to replace or upgrade their HR or FM system, they will migrate to service providers. Although there were additional requests by departments and agencies to become cross-agency service providers, the Administration has not expanded the list of potential providers beyond the original service providers selected last year.

Grants Management.—Currently, more than 900 programs in over 26 grant-making agencies provide $526 billion annually in Federal financial assistance. The evolution of grants management processes and systems has largely happened in a decentralized manner resulting in highly stove-piped operations. The cross-agency team identified a "consortia-based" approach to implementation and developed a process for forming consortia and agencies participating in consortia as members. The consortia approach aligns agency work teams (consortia) around shared business interests. Each consortium provides planning, leadership, business, and program direction with the goal of defining a common solution to meet its members' needs. The target operating model states the grants management community will process grants in a decentralized way using common business processes supported by shared technical support services and estimates savings of more than $2.4 billion can be expected between FY 2008 through FY 2015 through this consortia approach. To realize these benefits and cost savings, the Administration asked the taskforce for recommendations for agencies with the skills and capabilities to function as a Consortium Provider. The recommendations were evaluated similarly to the financial management and human resources cross-agency service providers assessing past performance, current capabilities and ability to operate a customer-focused organization. On the basis of the review, the following agencies were designated as eligible to be grants management consortia providers:

- Department of Education
- Department of Health and Human Services
- National Science Foundation

This year, the consortia providers will develop the infrastructure and capabilities necessary to cross-service other agencies including fee-for-service models with performance metrics.

Information Systems Security.—The cross-agency taskforce analyzed commonly used IT security processes and controls in an effort to identify the extent to which consolidation opportunities existed in the Federal Government. Their analysis indicated more than 25 percent ($1.4 billion) of the overall funds ($4.5 billion in FY 2006 up from $4.2 billion in FY 2005) go towards implementing four common processes—training, reporting, incident response and evaluating and selecting security products and services. The taskforce identified common solutions to be shared across Government and developed a joint business case outlining a general concept of operations with overall milestones and budget estimates. The Administration asked all agencies to submit proposals to either become a service provider for other agencies, or migrate to another agency from which they would acquire expert security services. Upon reviewing the proposals, the Administration will select the service providers for training and reporting during FY 2006 in conjunction with the Department of Homeland Security, who is continuing to serve as the program manager for this effort and will work with those agencies proposing to become service centers to bring greater clarity to their proposals. The taskforce will continue to explore the establishment of security centers of excellence in areas of incident response and evaluating and selecting products and processes.

With this President's Budget, the Administration plans to establish the following new LoBs:

- IT Infrastructure.—to further refine the opportunities for IT infrastructure consolidation and optimization and develop Government-wide common solutions. The LoB taskforce will define specific common performance measures for service levels and costs, identify best practices and develop guidance for transition plans within agencies and/or across agencies for activities such as IPv6. Consolidation and optimization of IT infrastructure represents a significant opportunity for future cost savings. Based on industry benchmarks and analysis of agencies' FY07 IT budget submissions, the Federal Government could potentially save between 16 percent and 27 percent annually on its IT infrastructure budget and between $18 billion and $29 billion over 10 years by taking a more coordinated approach to spending on commodity IT infrastructure, such as help desks, data centers, and telecommunications. IT infrastructure consolidation and optimization case studies also demonstrate agencies could improve IT service levels and, when relieved of the burden of managing these non-core functions, can concentrate more on mission priorities and results.
- Geospatial.—to identify opportunities for optimizing and consolidating Federal geospatial-related investments to reduce the cost of Government and improve services to citizens through business performance improvements. The LoB taskforce will analyze cost benefits, alternatives and risks, define roles and responsibilities, expected outcomes, performance measures, milestones, and timelines. The Federal Geographic Data Committee will continue to develop the National Spatial Data Infrastructure and full implementation will require Federal agencies to play a critical role; therefore, the establishment of the Geospatial LoB will ensure sustainable business model for Federal partners to establish a sustainable business model for Federal partners to collaborate on geospatial-related activities and investments.
- Budgeting.—to build toward a "budget of the future" employing standards and technologies for electronic information exchange to link budget, execution, performance, and financial information throughout all phases of the annual budget formulation and execution cycle. As first outlined in the FY 2004 Report to Congress on Implementation of the E-Government Act of 2002, the LoB taskforce will identify opportunities for common

solutions and automated tools to enhance agency and central budget processes. It will also:

—Promote integration and standardize information exchange between budget formulation, execution, financial management, and performance measurement systems and activities across Government;

—Institutionalize Budget and Performance Integration, including aligning programs and their outputs and outcomes with budget levels and actual costs; and

—Provide Government with enhanced capabilities for analyzing budget, performance, and financial information.

The Administration continues to leverage Government buying power while reducing redundant purchases through the SmartBUY program. Launched in June 2003, the SmartBUY program continues to provide increased cost avoidance savings to Federal agencies through new and existing agreements with commercial software providers. In FY 2005, the Federal Government signed a SmartBUY agreement with Oracle Inc. which provides a mandatory contract vehicle for all agencies purchasing Oracle database and database with security software products. The Federal Government has achieved avoidance of $174.8 million in the first six months of the contract alone. The SmartBUY Office continues to manage four agreements. The Administration anticipates the establishment of a new agreement in Spring 2006 with Antivirus software developers and will continue to identify and develop new agreements throughout the year.

Government IT Workforce.—Qualified Federal IT Project Managers with skilled interdisciplinary teams are the first line of defense against the cost overruns, schedule slippages, poor performance, and weakened security which threaten agencies' ability to deliver efficient and effective services to citizens.

On April 15, 2005, the Administration requested agencies to develop and submit to OMB plans for closing important IT skill and competency gaps. (Memorandum to the President's Management Council from Deputy Director for Management, "Human Capital Planning for the IT Workforce") The Chief Information Officers (CIO) Council identified IT Project Management, IT Architecture (Enterprise and Solutions), and IT Security as job activities important at the Federal level due to their direct contribution to fulfilling the E-Government element of the President's Management Agenda. Agency plans were submitted to OMB on August 30, 2005. The following chart highlights the current and planned staffing as submitted to OMB:

	# of Positions on Board	FY 2006 # of Positions to be Filled
IT Project Management	4,618.95	599.95
IT Security	9,030.40	488.47
IT Architecture (Enterprise)	1,168.67	179.80
IT Architecture (Solutions)	941.70	148.03
Total	15,759.72	1,416.25

Across all job areas, the most frequently occurring skill and competency gaps were:

- *Federal/OMB Enterprise Architecture*—Activities related to the business-based framework developed by OMB for Government-wide improvement;
- *Risk Management*—Knowledge of methods and tools used for risk assessment and mitigation of risk;
- *Standards*—Knowledge of standards which are either compliant with or derived from established standards or guidelines;
- *Process Design*—Activities related to the strategic establishment of the flow of information, control or materials from one activity to another;
- *Systems Analysis and Design*.—Activities related to the design, specification, feasibility, cost, and implementation of a computer system for business. Knowledge of the development and implementation process, metrics and tools for analysis, design and project management, quality factors and post evaluation techniques.

Although agencies are reporting gaps in the Enterprise Architecture (EA) job areas, a review of agency EA's indicates much progress has been made in EA Government-wide compensating for this skill gap through contractor support services. This is evidenced by all agencies having an effective EA (average evaluation of the EA section of the FY 2007 Business cases is 3.33 of 5) as assessed by OMB.

While agencies reported on their Exhibit 53's more than 70% of major IT investments as having a qualified project manager, there continue to be gaps in project management capabilities. In many cases, a project manager supports multiple investments, diminishing their effectiveness. Across the FY 2007 Business Cases, the average evaluation of the Project Management section is 3.21 (with a "3" defined as much work remains in order for Project Management to manage the risk of this project).

Agencies are addressing Project Management issues in several ways including additional training, mentoring, development of Communities of Practice, skills incentive programs, efforts to increase retention of staff, and increased recruiting efforts. Agency plans indicate in FY 2006 an overwhelming majority of these positions present a Medium or High risk to the agency of not being able to accomplish mission objectives (such as delivering critical functionality on schedule and within budget). Given competing budgetary priorities, the Administration will focus IT staffing efforts on job areas not demonstrating adequate results. As such, the agencies will, within agencies' funding levels, prioritize the hiring of IT Project Management positions rather than EA positions where possible. This prioritization of staffing allows agencies to make efficient use of resources while improving the quality of agency Project Management.

Going forward, the Administration will measure agency progress in further strengthening IT management—both in terms of hiring progress as well as training, mentoring, development of skills incentive programs, etc.—on a quarterly basis to inform PMA Scorecard decisions and reflected in the Human Capital Scorecard requirement.

Other initiatives sponsored or organized by the Office of Personnel Management, the General Services Administration, and the CIO Council further strengthen the Federal information technology workforce and ensure agencies can achieve their mission. An IT Quarterly Forum convenes to discuss and share promising practices regarding information technology initiatives. A partnership between CIO University and seven universities graduated over 600 students trained in Federal information technology management. Finally, the Scholarship for Service (Cyber Corps) Program provides more than 300 student scholarships and paid internships working on information security at agencies.

Securing Government Systems.—The Federal Government continues to improve the identification and resolution of long-standing, serious, and pervasive IT security problems. Agencies report quarterly on their efforts to address IT security weaknesses against key IT security performance measures.

The 2005 agency Federal Information Security Management Act (FISMA) reports reveal increased attention and progress in the area of system certification and accreditation. In FY 2005, the percentage of certified and accredited systems rose from 77 percent to 85 percent. In addition, overall quality of the certification and accreditation processes at agencies increased, with over two-thirds of the agencies having a process in place rated as "satisfactory" or better by the Inspector General (IG). To complement the certification and accreditation process, over 75 percent of agencies can demonstrate they have an effective process in place for identifying and correcting weaknesses.

Several agencies have made outstanding progress in FY 2005. For example, the Department of Defense moved from 58 percent to 82 percent of systems certified and accredited and the Department of Veterans Affairs improved from 14 percent to 100 percent.

The overall security status and progress in percentage of systems, from FY 2002 to FY 2005, is as follows:

	FY 2002	FY 2003	FY 2004	FY 2005
Effective Security and Privacy Controls (C&A)	47%	62%	77%	85%
Tested Contingency Plans	35%	48%	57%	60%
Total Systems reported	7,957	7,998	8,623	10,289

The number of agencies where the IG has verified the process exists to remediate IT security weaknesses (POA&M):

FY 2002	N/A (was not required in until FY 2003)
FY 2003	12
FY 2004	18
FY 2005	19

While notable progress in resolving IT security weaknesses has been made, challenges remain and new threats and vulnerabilities continue to materialize. Additional information and detail concerning the Federal Government's IT security program and agency IT security performance can be found in OMB's Annual Report to Congress on IT Security. The next such report will be issued by March 1, 2006 and will be made available on OMB's website.

Initiative to Secure Federal Information Systems and Facilities.—Inconsistent agency approaches to facility security and computer security are inefficient and costly, and increase risks to the Federal Government. On August 27, 2004 the President signed Homeland Security Presidential Directive (HSPD) 12, "Policy for a Common Identification Standard for Federal Employees and Contractors," which requires agencies to implement a mandatory, Government-wide standard for secure and reliable forms of identification for Federal employees and contractors. HSPD–12 requires a complex deployment on an accelerated time table. During FY 2006–FY 2008, agencies are required to complete issuance of these IDs to all applicable employees and contractors and install infrastructure to use them.

Protecting Privacy.—OMB instituted several important measures for privacy management this fiscal year. On February 11, 2005, OMB's Memorandum M–05–08, "Designation of Senior Agency Officials for Privacy," requesting each executive department and agency to identify a Senior Agency Official for Privacy to assume overall responsibility and accountability for ensuring the agency's compliance with privacy law and policy. The Administration requested the Senior Agency Officials for Privacy across Government to assume responsibility for coordinating their agencies' responses on the FISMA privacy template. Finally, privacy has been added to the "maintaining green" criteria of the Expanded Electronic Government element of the President's Management Agenda.

Making Government Accessible to All.—The efficient, effective, and appropriately consistent use of Federal agency public websites is important to promote a more citizen centered Government. Federal agency public websites are information resources funded by the Federal Government and operated by an agency, contractor, or other organization on behalf of the agency. They present Government information or provide services to the public or a specific non-Federal user group and support the proper performance of an agency function.

Cost-effective and consistent access to and dissemination of Government information is essential to promote a more citizen-centered Government. The Administration's recent guidance identifies procedures to organize and categorize information and make it searchable across agencies to improve public access and dissemination, discusses using the Federal Enterprise Architecture Data Reference Model (DRM), and reminds agencies of the breadth of their existing responsibilities primarily related to information access and dissemination.

Agencies are managing innovative information dissemination programs for their own agency information and services. While agencies remain ultimately responsible for disseminating their own information, they are working collaboratively to provide access to the public and are taking advantage of a variety of dissemination channels. Consequently, Federal information is disseminated by Federal agencies as well as diverse nonfederal parties, including State and local government agencies, for-profit organizations, and educational and other not-for-profit organizations such as libraries and community centers. These dissemination channels also aid the public in accessing Federal information and services by providing the skills, knowledge, and training for citizens to access various information resources (see *http://www.whitehouse.gov/omb/inforeg/section—213—report—04-2005.pdf*).

The Federal Government continues to ensure electronic information technology is accessible to people with disabilities as required by Section 508 of the Rehabilitation Act of 1973. The creation of the Buy Accessible Wizard, a web-based application developed by the General Services Administration, helps agencies determine relevance, applicability, and compliance to Section 508 when managing electronic and information technology products and services. The application helps Federal program managers to consistently and correctly apply the Federal Acquisition Regulation to their market research. In April 2005, the Civilian Agency Acquisition Council and the Defense Agency Acquisition Council published a final rule requiring micro purchase to comply with the requirements of Section 508. Micro purchases were previously exempt from these requirements to give agencies time to update purchase card training modules on the 508 requirements and implement necessary training. Free on-line training is available at *http://www.section508.gov*.

SUCCESSFULLY USING ELECTRONIC GOVERNMENT

The departments and agencies continue to seek to leverage information technologies to make Government services available to the citizen while ensuring security of those systems, the privacy of the citizen information and the prudent use of taxpayer money. E-Government is about providing direct and measurable results supporting departments' and agencies' mission and goals. For departments and agencies, the benefits must far outweigh the cost of implementation. In the coming months, the Presidential E-Government initiatives graduate from development and implementation phases to mature service offerings supported by service fees. Increased agency adoption and customer utilization will become the primary measures of success. The expanded availability of Government information and the utilization of an increased percentage of transactions between the Federal Government and citizens will be measured, where appropriate.

Examples of how the tenets of E-Government are helping to deliver services to the citizen and make the Government more effective include:

The Department of Interior (DOI) has the responsibility to manage federally owned resources, protect the environment, prevent, detect, and investigate criminal activity and manage visitor use and protection programs. The Incident Management Analysis and Reporting System (IMARS) provides a Department-wide information collection, analysis, and reporting system for incident information, which are defined as any occurrence requiring documentation.

Currently, it is not possible to query and analyze incidents across multiple National Park Service (NPS) parks or other DOI Bureaus. The new system aggregates and disseminates incident information, improving DOI's ability to prevent, detect, and investigate criminal activity, and thereby aid in protecting the public, as well as natural and cultural resources. The system also helps DOI to prioritize protection efforts and complete reports required to evaluate agency programs and services.

An advisory council insures the requirements of DOI bureaus are included. The Council includes representatives from non-law enforcement subject areas, as well as the NPS, the Bureau of Reclamation, Fish and Wildlife Service, the Bureau of Indian Affairs, and the Bureau of Land Management. The system will also interface with criminal information sharing networks at other Federal, State, and local governments. Information on the system is accessible to those who are disabled, and resources are available to answer questions or provide assistance when necessary. Services and information disseminated by the system can also be provided in alternative media as well.

The timeliness and number of successfully adjudicated cases, as well as the number of illegal incidents leading to damage or loss to Federal or private property located on DOI lands or areas of interest are key performance indicators demonstrating the impact of the system on agency programs and services. The system will reduce operational costs by replacing and integrating isolated law enforcement efforts into a centralized and common infrastructure, and eliminate the need for duplicative technologies and training.

The Department of Education has improved mission critical internal processes by developing an online e-monitoring system to provide grant monitoring functionality for Department staff. The system allows all Department users, across multiple agencies, access to essential grant management information. The application enhances the Department's ability to effectively manage grants by improving the efficiency of the Department's grant processing. For example, the system allows users to analyze budget and financial summary data over the lifecycle of the grant, as well as monitor, track, and report grant status and trends. The system also aids in grants processing by allowing users to reassign grants for review and receive notice of inadequate and excessive grant drawdown.

While the initiative is designed to assist Department employees in monitoring recipients of Department grants, and is not used by external partners, it does improve the Department's interaction and communication with external partners and grantees. For example, the system allows users to log email, phone or mail communications of any given grant, as well as print mailing labels and send bulk emails to aid in information dissemination. Performance agreements of applicable Department employees required use of the system, reinforcing the importance of the initiative.

The system has been implemented in one program office, and there are plans to roll out the tool to other Department program offices over the next year. The system will be evaluated to assess performance and impact on improving the agency mission, and the Department is establishing performance measures (including cost savings and avoidance) based on baseline data collected this year.

The Administration continues the focus of the department and agency specific services towards citizen-centered services. Overall funding for the President's E-Government initiatives has reduced annually since FY 2004 as the initiatives have met their milestones and have become incorporated into the daily operations of Federal departments and agencies. This reduction has come as result of moving the initiatives to fee-for-service models where appropriate, thereby eliminating the need for agency contributions. Chapter 9, Table 9–3, "Status of the Presidential E-Government Initiatives," included on the CD–ROM, provides an update for each project.

LOOKING AHEAD—MORE RESULTS

Current Federal Government initiatives inclusive of the President's E-Government initiatives augmented by the current analysis of the LoBs will increase the requirement for departments and agencies to facilitate a change from a "closed" agency technical architecture to an interoperable Federal architecture. In order for the departments and agencies to overcome technical limitations arising from this need to interoperate and support emerging requirements and technologies, the Administration set June 2008 as the date by which all agencies' infrastructure (network backbones) must be using IPv6 and agency networks must interface with this infrastructure. In August 2005, OMB issued guidance to agencies in Memorandum M–05–22, "Transition Planning to Internet Protocol Version 6 (IPv6)," to ensure an orderly and secure transition from Internet Protocol Version 4 (IPv4) to Version 6 (IPv6). Since the Internet Protocol is core to an agency's IT infrastructure, beginning in February 2006, the Administration will use the Enterprise Architecture Assessment Framework to evaluate agency IPv6 transition planning and progress, IP device inventory completeness, and impact analysis thoroughness. The August 2005 memorandum discussed a series of actions agencies must take by specific dates. For instance, by November 15, 2005, agencies were to: (1) assign an official to lead and coordinate agency planning and (2) complete an inventory of existing routers, switches, and hardware firewalls. To date, 23 (of 24) large agencies have provided the requested information and 38 (of 107) small agencies.

Additionally, the President's National Strategy to Secure Cyberspace directed the Secretary of Commerce to form a taskforce to examine the most recent iteration of the Internet Protocol, IP version 6 (IPv6). The President charged the taskforce with considering a variety of IPv6-related issues, "including the appropriate role of government, international interoperability, security in transition, and costs and benefits." The taskforce, co-chaired by the Administrator of the National Telecommunications and Information Administration (NTIA) and the Director of the National Institute of Standards and Technology (NIST), prepared a report discussing the benefits and impacts of IPv6. This report was published in January 2006.

The Administration will continue to use the Federal Enterprise Architecture data for business analysis to focus our efforts to direct information technology investments to improve service delivery to citizens and other entities. The Administration will continue to improve performance and achieve results by continuing our efforts in linking IT investments to program performance as demonstrated by the analytical tool called the Program Assessment Rating Tool (PART).

In 2007 and beyond, the Federal Government will continue to identify IT opportunities for collaboration and consolidation while improving services. Although the Federal Government continues to improve, much more work is needed to better serve the citizen. Through the PMA, the Clinger-Cohen Act, the E-Government Act, FISMA, budget guidance and other management tools, the Federal Government has the ability to be the best manager, innovator and user of information, services and information systems in the world. The President's E-Government initiatives will have graduated from development and implementation phases to mature service offerings supported by service fees. The future is to ensure reliability, security and continuity of services to the point where the services are thought of as utilities just like electricity and water. This service and results oriented approach will ensure the future Government IT investments will leverage existing capabilities to their maximum potential and will provide cost-effective and customer-centered services.

10. FEDERAL DRUG CONTROL FUNDING

Table 10–1. Federal Drug Control Funding, FY 2005–2007[1]

(Budget authority, in millions of dollars)

Department/Agency	2005 Enacted	2006 Estimate	2007 Request
Department of Defense	1,147.8	936.1	926.9
Department of Education	590.5	490.9	165.9
Department of Health and Human Services:			
National Institute on Drug Abuse	1,006.4	1,000.0	994.8
Substance Abuse and Mental Health Services Administration	2,490.5	2,442.5	2,411.1
Total HHS	3,496.9	3,442.5	3,405.9
Department of Homeland Security:			
Customs and Border Protection	1,429.0	1,591.0	1,796.5
Immigration and Customs Enforcement	361.5	436.5	477.9
U.S. Coast Guard	871.9	1,032.4	1,030.1
Total DHS	2,662.4	3,059.9	3,304.6
Department of Justice:			
Bureau of Prisons	48.6	49.1	51.0
Drug Enforcement Administration	1,793.0	1,876.6	1,948.6
Interagency Crime and Drug Enforcement	553.5	483.2	706.1
Office of Justice Programs	281.1	237.4	248.7
Total Department of Justice	2,676.2	2,646.3	2,954.3
ONDCP:			
Counterdrug Technology Assessment Center	41.7	29.7	9.6
Operations	26.8	26.6	23.3
High Intensity Drug Trafficking Area Program[2]	226.5	224.7	....
Other Federal Drug Control Programs	212.0	193.0	212.2
Total ONDCP	507.0	474.0	245.1
Department of State:			
Bureau of International Narcotics and Law Enforcement Affairs	1,163.1	1,028.2	1,166.7
Department of Treasury:			
Internal Revenue Service	....	55.0	55.6
Department of Veterans Affairs:			
Veterans Health Administration	396.1	412.6	428.3
Other Presidential Priorities[3]	2.2	1.0	2.5
Total Federal Drug Budget	**12,642.3**	**12,546.6**	**12,665.8**

[1] Detail may not add due to rounding.

[2] Beginning in FY 2007, the High Intensity Drug Trafficking Area Program is transferred to Justice and incorporated into the Interagency Crime and Drug Enforcement account.

[3] Includes the Small Business Administration's Drug-Free Workplace grants and the National Highway Traffic Safety Administration's Drug Impaired Driving program.

11. CALIFORNIA–FEDERAL BAY–DELTA PROGRAM BUDGET CROSSCUT (CALFED)

The California-Federal Bay-Delta program (also known as CALFED) is a cooperative effort of the Federal Government, the State of California, local Governments, and water users, to proactively address the water management and aquatic ecosystem needs of California's Central Valley. This valley, one of the most productive agricultural regions of the world, is drained by the Sacramento River in the north, and the San Joaquin River in the south. The two rivers meet southwest of Sacramento, forming the Sacramento-San Joaquin Delta, and drain west into San Francisco Bay.

The extensive development of the area's water resources has significantly boosted agricultural production, but has also adversely affected the region's ecosystems. CALFED participants recognized the need to provide a safe, clean, reliable source of water for multiple uses, while at the same time restoring or maintaining the ecosystems of the area and protecting against floods. This recognition resulted in the 1994 Bay-Delta Accord, which laid the foundation for the CALFED program. CALFED's adaptive management approach to water resources development and management seeks to balance achievement among the program's four objectives: Water Supply Reliability, Levee System Integrity, Water Quality, and Ecosystem Restoration. The program integrates science and monitoring into program management to track progress toward achieving those goals. The parties signed a Record of Decision in 2000, spelling out the different program components and goals.

In 2004, the President signed the Calfed Bay-Delta Authorization Act (P.L. 108–361) into law. This Act, authorizing funding and activities for the CALFED program through 2010, provides new programmatic authority for participating agencies, authorizes $395 million to be appropriated for the Federal share of CALFED activities, and specifies criteria for program cost-shares and achieving balanced implementation of CALFED program components. Federal agencies contributing to CALFED goals include: the Department of the Interior's Bureau of Reclamation, Fish and Wildlife Service, and U.S. Geological Survey; the Department of Agriculture's Natural Resources Conservation Service; the U.S. Army Corps of Engineers; the Department of Commerce's National Oceanic and Atmospheric Administration; and the Environmental Protection Agency.

The Budget includes a crosscut of Federal funding by each of the CALFED agencies, fulfilling the reporting requirements of P.L. 108–361. Detailed tables are included on the CD–ROM included with the *Analytical Perspectives*, as well as an explanation of budget crosscut methodology.

CALFED–RELATED FEDERAL FUNDING BUDGET CROSSCUT

Federal Fiscal Years 1998–2007

(Dollars in millions)

	1998 [1]	1999 [1]	2000 [1]	2001 [1]	2002 [1]	2003 [1]	2004 [1]	2005 [1]	2006 [2]	2007 [3]
Bureau of Reclamation	$149.627	$107.063	$130.503	$79.030	$126.775	$83.403	$78.929	$81.104	$95.786	$83.973
Corps of Engineers	$100.686	$103.341	$93.786	$54.192	$58.227	$70.624	$65.070	$50.763	$93.819	$75.700
Natural Resources Conservation Service	....	$14.543	$12.845	$16.945	$39.078	$38.998	$48.745	$36.393	$35.000	$35.000
National Oceanic and Atmospheric Administration	$0.300	$0.375	$0.450	$0.550	$0.575	$0.775	$0.775	$0.775	$0.375	$0.775
Geological Survey	$3.158	$3.158	$4.319	$5.366	$5.039	$5.039	$4.910	$4.867	$2.066	$4.919
Fish & Wildlife Service	$0.941	$1.143	$3.647	$18.230	$5.605	$11.189	$13.684	$2.018	$3.787	$2.063
Environmental Protection Agency	$3.204	$3.049	$57.262	$53.375	$54.255	$20.693	$1.502	$96.661	....	....
Total	**$257.916**	**$232.672**	**$302.812**	**$227.688**	**$289.554**	**$230.721**	**$213.615**	**$272.581**	**$230.833**	**$202.430**

[1] 1998–2005 totals reflect actual obligations.

[2] 2006 totals reflect estimates based on enacted levels.

[3] 2007 totals reflect amounts requested in the President's Budget.

ECONOMIC ASSUMPTIONS AND ANALYSES

12. ECONOMIC ASSUMPTIONS

By the end of 2005 the U.S. economy had entered its fifth year of expansion, exhibiting a sustained solid pace of economic growth, with low rates of unemployment and underlying inflation, rising payroll jobs, high homeownership rates, strong business investment, and a record level of real household wealth. This robust performance of the economy stands in marked contrast to the economic slowdown and recession of 2000–2001 followed by the slow recovery in 2002–2003.[1] The sluggish performance during those years resulted from a number of unanticipated shocks, including sharp declines in stock market valuations beginning in 2000; falling manufacturing production and business investment; and corporate accounting scandals. The terrorist attacks of September 11, 2001 were a further shock aimed at the heart of the U.S. economy and government. The renewed solid economic performance since mid-2003 is a testament to the resilience of the U.S. economy and the adoption of successful pro-growth policies, including tax relief, Federal Reserve monetary policy actions, and ongoing efforts to promote liberalized international trade and investment in innovative technologies.

The performance of the economy over the past year provided further evidence for the robust nature of the expansion in the face of additional shocks. The economy continued its solid performance despite high energy prices and the substantial damage and disruptions from the worst hurricane season on record. Hurricanes Katrina, Rita, and Wilma resulted in significant loss of life, destruction of property and productive assets, disruption of local Gulf Coast populations and living conditions, and sharp increases in energy prices. Even so, during the very quarter of the year when the hurricanes hit, the economy still registered growth in real gross domestic product (GDP) in excess of 4 percent at an annual rate. And by the final quarter of the year, most economic indicators that had shown short-lived adverse effects had returned to their pre-storm-season paths.

As we move into 2006 and look forward to future years, the Administration and other public and private forecasters expect the expansion to continue for the foreseeable future, with sustained non-inflationary real growth, and the economy providing a solid foundation for the Federal budget outlook.

Recent Economic Performance

At the time of the preparation of the 2007 Budget, real GDP in the U.S. economy has been increasing for 16 consecutive quarters, with the latest 10 consecutive quarters showing average growth rates of 4.1 percent and no quarter during the period growing slower than 3.3 percent. Over the 4 quarters of 2005, the economy was on track to register real GDP growth at about a 3.5 percent pace, following the 3.8 percent growth rate during 2004 and the 4.0 percent rate of 2003. By virtually all signs, the expansion has entered a self-reinforcing phase, with growth widespread across various components and sectors.

Increases in employment and ongoing strong gains in the efficiency of the U.S. workforce—that is, high growth in labor productivity—have combined to generate the sustained solid growth in real output.

- In labor markets, nonfarm payroll employment has increased by 4.6 million jobs since the post-recession low in May 2003, with 2 million of those job gains occurring during 2005—or about a 1.5 percent increase in payroll employment in the past year alone.
- Reflecting the improving labor situation, the unemployment rate declined to 4.9 percent in December 2005, down from a post-recession high of 6.3 percent in June 2003.
- Labor productivity gains—the increase in output per hour of labor—have been remarkably strong in recent years, providing a substantial boost to growth in real GDP. For example, output per hour in the nonfarm business sector was on track to rise by about 2.5 percent during 2005, following an increase of 2.6 percent during 2004 and an especially robust increase of 5.0 percent during 2003.
- The recent productivity gains reinforce the stronger trend productivity performance of the past decade. Since 1995, labor productivity in the nonfarm business sector has increased at about a 2.9 percent annual rate, compared to a 1.4 percent annual rate of gain in the period from 1973 to 1995.

Stronger growth in labor productivity is a fundamental building block for the longer-term performance of the economy and represents the essential basis for increasing standards of living for American workers and families.

At times in the past, after the economy had grown at a relatively strong pace with declining unemployment for an extended period—such as we have seen recently—there was an increase in inflationary pressures. That was the repeated experience in the 1960s and 1970s and early 1980s. Since 2003, however, strong gains in labor productivity have helped to keep the underlying rate of inflation low by historical standards despite the generally robust economic performance. Strong gains in productivity reduce production costs and keep down the pressures on output prices.

[1] Economic performance is discussed in terms of calendar years. Budget figures are in terms of fiscal years.

Although rising productivity growth when supported by responsible monetary policy can keep inflation under control in the long run, other factors can affect the short-run behavior of prices and inflation:

- Primary commodity prices generally have been on a strong upward trend over the past 4 years reflecting increased demand associated with the stronger U.S. and international economies, and some depreciation of the U.S. dollar over this period.
- Energy prices—notably crude oil and natural gas prices—have increased sharply over the past 4 years. For example, the benchmark price for West Texas Intermediate crude oil increased from just under $20 a barrel in December 2001 to about $65 a barrel in August 2005. Over the same period, the national average retail gasoline price rose from $1.09 a gallon to more than $2.60 a gallon.
- The destruction of oil and natural gas facilities and the shutdown of gasoline refineries along the coast of the Gulf of Mexico from Hurricanes Katrina and Rita contributed to further volatility and increases in energy prices during August and September 2005. Crude oil prices initially rose sharply, with West Texas Intermediate crude oil reaching nearly $70 a barrel in early September, before falling back to hover around $60 a barrel over the final 2 months of the year. Gasoline prices initially rose above $3 a gallon and stayed near that level until beginning a gradual decline in mid-October, falling to about $2.25 by the end of the year.
- The rise in energy and gasoline prices contributed to a slight increase in the "headline" rate of inflation during 2005: the consumer price index (CPI) rose 3.4 percent during 2005 (December to December), up from a 3.3 percent rate during 2004.
- Even so, abstracting from volatile food and energy items shows that "core" CPI inflation was 2.2 percent during 2005, a very low rate by historical standards. The price index for personal consumption expenditures excluding food and energy items from the National Income and Product Accounts (NIPAs)—which uses a method of calculation that eliminates one source of upward bias that exists in the CPI measures—was on track for an increase of less than 2 percent during 2005.

The key point to recognize is that, despite rising commodity and energy prices that have led to a temporary increase and heightened volatility in the overall rate of inflation, underlying inflation remains subdued and inflation expectations do not appear to be adversely affecting business or household decisions.

Indicators of real economic activity provide additional evidence for the strong, sustained growth performance of the U.S. economy in recent years and during 2005, and illustrate the broad-based nature of the expansion:

- Through the first 3 quarters of 2005, real consumer spending increased at a 3.6 percent annual rate, following increases at a 3.8 percent rate during both 2003 and 2004. In the fourth quarter, consumption spending slowed down, mainly because of a sharp drop in motor vehicle sales in the fall. Real consumption gains resumed in the last 2 months of the quarter, however, coinciding with a rebound in consumer confidence following temporary declines in sentiment following Hurricanes Katrina and Rita, and consumption spending does not appear to have suffered a permanent shock.
- Manufacturing activity and private investment spending have been strong in recent years, rebounding from the 2000–2001 slowdown and recession. Manufacturing industrial production rose 2.8 percent during 2005, and has increased at more than a 4.5 percent annual rate over the past 2½ years. Real business equipment and software spending rose at a 10 percent annual rate through the first 3 quarters of 2005 and has increased at an 11 percent annual rate over the past 2¼ years.
- Housing market activity continues to show its best sustained performance in more than a quarter century. There were 2.1 million housing starts in 2005, following 1.95 million starts in 2004. Over the past 2 years, the national homeownership rate continued to run near record levels of about 69 percent. According to the National Association of Realtors, the median price of existing homes increased 13 percent over the most recent 12-month period. The housing boom is expected to moderate in 2006 and beyond, but without sharp declines in national housing prices or residential investment.
- Increasing housing wealth and higher stock market valuations have boosted real household wealth to record levels. At the end of the third quarter of 2005, household wealth reached $51 trillion—or 5 times the level of annual personal income—up 7.6 percent over the prior last quarters after adjusting for inflation. The real value of household real estate assets increased by 11 percent, and the real value of household holdings of corporate equities, mutual funds, and pension funds rose by 6 percent during the last 4 quarters.

In general, economic performance during 2005 and the data and information from the past several years confirm that the U.S. economy is fundamentally strong, supporting the outlook for continued expansion with non-inflationary real growth.

Policy Background

The fiscal and monetary policies of the past 5 years have successfully contributed to the current good economic performance. The general fiscal policy outlook—as presented in the President's Budget—continues to be consistent with the outlook for sustained expansion in the U.S. economy for the foreseeable future.

The resilience of the U.S. economy in 2005 despite the economic and social disruptions caused by the hurricanes echoed the economic recovery from the variety of shocks that hit the economy over the 2000–2003 period. Looking back, timely tax relief and reductions in interest rates promoted a rebound from the economic slowdown, helping our Nation overcome the adverse effects from these shocks, which included the bursting of the stock market bubble of the late 1990s; the terrorist attacks of September 11, 2001; problems with corporate malfeasance; and the uncertainty associated with an international war on terrorism and military conflicts in Afghanistan and Iraq. Those policies continue to provide a solid foundation for current and future economic performance.

Policy Actions

Fiscal Policy: Beginning in 2001, the Administration proposed, and Congress enacted, significant tax relief designed to overcome the shocks and recession—promoting recovery in the growth of output, income, and jobs—and to provide a strong basis for continued economic expansion in the long term.

- *The Economic Growth and Tax Relief and Reconciliation Act of 2001* lowered marginal income tax rates; reduced the marriage tax penalty; and created a new, lower 10 percent tax bracket, among other changes. In July 2001, near the low point of the 2001 recession, taxpayers began receiving rebate checks reflecting their lower liability with the new 10 percent bracket; lower withholding schedules also went into effect at that time.
- *The Job Creation and Worker Assistance Act of 2002* permitted immediate depreciation of 30 percent of the value of qualified new capital assets put in place during the three years ending September 11, 2004. Accelerated depreciation provided an incentive for firms to invest. For a limited time, more of a qualified investment could be written-off for tax purposes, thereby lowering the cost of capital and providing an incentive for firms to speed up their capital spending. The Act also extended unemployment insurance benefits to workers who had exhausted their normal benefits.
- *The Jobs and Growth Tax Relief Reconciliation Act of 2003* lowered income tax rates, reduced the marriage penalty, raised the child tax credit, and raised the exemption amount for the individual Alternative Minimum Tax. The Act reduced tax rates on dividend income and capital gains, reducing distortions in the tax code from the double taxation of corporate earnings. To stimulate business capital spending further, the Act raised the percentage of an asset's value that could be expensed immediately from 30 to 50 percent and lengthened the window of opportunity for businesses to take advantage of this benefit from September 11, 2004 to the end of the year. The Act also raised the maximum amount that a small business could expense from $25,000 per year to $100,000.
- *The Working Families Tax Relief Act of 2004* extended parts of the President's tax relief plan that were scheduled to expire at the end of 2004 and reinstated several expired or expiring business-related tax incentives. In doing so, the Act protected taxpayers from several scheduled tax increases. The Act also provided tax relief to certain military personnel with families, and simplified the tax code for many families by creating a uniform definition of a qualifying child for tax purposes.

Efforts continue to preserve the favorable tax environment the President and the Congress have created. Maintaining a relatively low tax environment in the United States is a central element of the Administration's economic and budget policies. The Administration's budget proposals, including sustained lower taxes and significant spending restraint, will reduce the Federal budget deficit in coming years as a share of GDP, so that publicly held debt is projected to remain relatively stable, and eventually to decline, relative to the size of the economy.

Monetary Policy and Interest Rates: As we enter 2006, Federal Reserve monetary policy continues to be oriented toward promoting sustained non-inflationary, real growth in the U.S. economy. Looking back, from early 2001 through mid-2003 monetary policy was focused on overcoming negative shocks and restoring stronger real growth. The Federal Reserve lowered the target Federal funds rate—a key interbank overnight interest rate—13 times, from 6½ percent to 1 percent. That low rate was maintained until June 2004 when the Federal Reserve began to increase the funds rate gradually, reflecting the accumulating evidence of improved economic performance and the outlook for sustained future growth. By December 2005, the Federal Reserve had raised the funds rate to 4¼ percent. In its statement accompanying the December increase, the Federal Reserve stated that "some further measured policy firming is likely to be needed to keep the risks to the attainment of both sustainable economic growth and price stability roughly in balance." The Administration forecast for the 3-month Treasury bill rate, presented below, is consistent with market expectations reflecting the outlook for "further measured policy firming."

Longer-term interest rates, notably the yield on 10-year Treasury notes, remained low by historical standards during 2005. The 10-year rate traded as low as 3.9 percent and as high as 4.6 percent during the year, but it ended the year at just under 4.4 percent, not much different from where it began the year. With the increases in the Federal funds rate during the year to 4¼ percent, the low 10-year Treasury yield at the end of the year produced a very flat structure of interest rates across short- to long-term maturities. The low levels of longer-term interest rates—including those for corporate securities and for residential mortgages—

have been key factors promoting the strong gains in business and residential investment.

Challenges

Even though the general outlook is for continued healthy expansion for the U.S. economy, a number of challenges remain, including:

- The strong performance of residential construction and the increases in housing prices and wealth of recent years have introduced concerns about the future performance of housing markets and the implications for general economic activity should the housing boom end precipitously. Most analysts anticipate that an orderly transition will occur to a more moderate pace of housing activity with stabilizing prices. Although risks remain, the general expectation is that household consumption spending and overall economic performance will not be significantly affected if the housing adjustment is moderate and gradual.
- The U.S. continues to run mounting international trade and current account deficits, and concerns persist about their sustainability. These international deficits are largely the result of the persistant strength of the U.S. economy relative to our foreign trading partners. Most forecasters expect that the pressures tending to raise international deficits will alleviate somewhat going forward reflecting changes in key determinants, including expected improvements in the growth rates of foreign economies. The general expectation is that the U.S. trade position will gradually improve in coming years, consistent with the outlook for ongoing sustained expansion in the U.S. economy.
- Strong consumption spending in recent years has resulted in a low measured rate of personal saving. The increases in household wealth from higher housing and stock market valuations, and the associated increases in consumption, can account for much of the lower saving rate. An orderly transition in residential housing markets, if coupled with ongoing solid corporate equity valuations and rising real incomes, will not dampen consumption spending.
- The Federal budget outlook presents potential challenges. During 2005, the worst hurricane season on record resulted in additional costs for the Federal Government for rebuilding and disaster relief efforts. Other special costs continue, including for the international War on Terror and ongoing efforts in Afghanistan and Iraq. The short-term increases in the budget deficit require further efforts for fiscal discipline. Over the next five years, the Administration's budget proposals call for reduction in the Federal budget deficit as a share of GDP, and the publicly held debt is projected to remain relatively stable, and then to decline, relative to the size of the economy. Those patterns for the deficit and the debt are consistent with a sustainable fiscal policy that will coincide with continued expansion. Beyond the five-year budget horizon, the effects of demographic changes and rising health care costs on entitlement programs make the long-term outlook for the deficit and the debt more problematic, as discussed in Chapter 13 of this volume, "Stewardship."

Although these factors represent potential risks and challenges, the current outlook continues to be one of a gradual and orderly transition that will support the ongoing expansion in the U.S. economy.

Economic Projections

The Administration's economic projections, based on information available as of mid-November 2005, are summarized in Table 12–1. These assumptions are close to those of the Congressional Budget Office and the consensus of private-sector forecasters, as described in more detail below and shown in Table 12–2. In brief, the assumptions call for a continuation of the recent trends of strong, sustained growth; solid jobs growth; low inflation; and, even allowing for a projected rise in the next few years, relatively low interest rates.

Real GDP, Potential GDP, and Unemployment Rate: Real GDP, which is estimated to have increased 3.6 percent in 2005 on a year-over-year basis, is projected to increase 3.4 percent this year. During the next few years, both actual and potential growth are likely to continue to moderate further to about 3.1 percent. As a result, the unemployment rate, fluctuating narrowly around 5.0 percent for the last nine months of 2005, is projected to remain at that level. That rate is the center of the range that is thought to be consistent with stable inflation. The main sources of growth in demand in coming years are likely to be business capital spending, net exports, and to a lesser extent, consumer spending. The contributions to overall growth from residential investment and the government sector are expected to be small at best.

For the private business sector of the economy, potential growth is approximately equal to the sum of the trend rates of growth of the labor force and of productivity. Potential growth of total GDP (including government sectors) is projected to be about 3¼ percent over the next two years, trending down to 3.1 percent after 2008, primarily because of an assumed slowing in labor force growth. The labor force is projected to grow about 1.3 percent per year through 2007 on average, slowing to about 0.9 percent yearly on average during 2008–2011 as increasing numbers of baby boomers enter retirement.

Trend productivity growth in the nonfarm business sector[2] is assumed to be 2.6 percent per year. The 2.6 percent trend pace is noticeably below the average since the business cycle peak in the first quarter of 2001 (3.6 percent per year). It is, however, close to

[2] The nonfarm business sector accounts for about three-fourths of the value of GDP, with households, institutions and government accounting for the remainder. The nonfarm business sector serves as the standard metric for productivity because of its reliable measurement.

Table 12–1. ECONOMIC ASSUMPTIONS [1]

(Calendar years; dollar amounts in billions)

	Actual 2004	Projections						
		2005	2006	2007	2008	2009	2010	2011
Gross Domestic Product (GDP):								
Levels, dollar amounts in billions:								
Current dollars	11,734	12,482	13,210	13,949	14,713	15,493	16,310	17,177
Real, chained (2000) dollars	10,756	11,139	11,514	11,896	12,284	12,669	13,062	13,467
Chained price index (2000=100), annual average	109.1	112.1	114.7	117.3	119.8	122.3	124.9	127.5
Percent change, fourth quarter over fourth quarter:								
Current dollars	6.8	6.4	5.6	5.6	5.4	5.3	5.3	5.3
Real, chained (2000) dollars	3.8	3.5	3.4	3.3	3.2	3.1	3.1	3.1
Chained price index (2000=100)	2.9	2.8	2.2	2.2	2.1	2.1	2.1	2.2
Percent change, year over year:								
Current dollars	7.0	6.4	5.8	5.6	5.5	5.3	5.3	5.3
Real, chained (2000) dollars	4.2	3.6	3.4	3.3	3.3	3.1	3.1	3.1
Chained price index (2000=100)	2.6	2.7	2.4	2.2	2.1	2.1	2.1	2.1
Incomes, billions of current dollars:								
Corporate profits before tax	1,059	1,425	1,506	1,497	1,516	1,495	1,497	1,500
Wages and salaries	5,389	5,745	6,095	6,459	6,843	7,229	7,613	8,028
Other taxable income [2]	2,420	2,495	2,618	2,717	2,877	2,974	3,105	3,231
Consumer Price Index: [3]								
Level (1982–84=100), annual average	188.9	195.3	201.1	205.9	210.9	215.9	221.1	226.6
Percent change, fourth quarter over fourth quarter	3.4	3.8	2.4	2.4	2.4	2.4	2.4	2.5
Percent change, year over year	2.7	3.4	3.0	2.4	2.4	2.4	2.4	2.5
Unemployment rate, civilian, percent:								
Fourth quarter level	5.4	5.0	5.0	5.0	5.0	5.0	5.0	5.0
Annual average	5.5	5.1	5.0	5.0	5.0	5.0	5.0	5.0
Federal pay raises, January, percent:								
Military [4]	4.15	3.5	3.1	2.2	NA	NA	NA	NA
Civilian [5]	4.1	3.5	3.1	2.2	NA	NA	NA	NA
Interest rates, percent:								
91-day Treasury bills [6]	1.4	3.2	4.2	4.2	4.3	4.3	4.3	4.3
10-year Treasury notes	4.3	4.3	5.0	5.3	5.5	5.6	5.6	5.6

NA = Not Available.
[1] Based on information available as of November 15, 2005.
[2] Dividends, rent, interest, and proprietors' income components of personal income.
[3] Seasonally adjusted CPI for all urban consumers.
[4] Percentages apply to basic pay only; 2004 figure is average of various rank- and longevity-specific adjustments; percentages to be proposed for years after 2007 have not yet been determined.
[5] Overall average increase, including locality and special pay adjustments. Percentages to be proposed for years after 2007 have not yet been determined.
[6] Average rate, secondary market (bank discount basis).

the pace during 1996–2000 (2.5 percent) and not far from the average since the official productivity series began in 1947 (2.3 percent).

Inflation: Inflation increased in 2005, in large part because of surging energy prices. With the recent easing of these prices, inflation is likely to be lower in 2006. On a year-over-year basis, the CPI is projected to increase 3.0 percent this year with the increase moderating to 2.4 to 2.5 percent a year through 2011. This inflation rate is lower than the average during each decade of the 1970s, 1980s, and 1990s. The GDP price index is projected to increase 2.2 or 2.1 percent in each year through 2011, slightly less than the CPI, which is the usual pattern.

The forecast of low inflation reflects the current very low core inflation rate, modest inflationary expectations, the downward pressure on wages and prices due to both domestic and global competition, and the Federal Reserve's focus on measured policy firming so as to avoid an over-heated economy.

Interest Rates: Interest rates are projected to rise, as is the usual case during an expansion. The 3-month Treasury bill rate, which was 4.0 percent at the end of December, is expected to increase to 4.3 percent by 2008. The yield on the 10-year Treasury note, 4.3 percent at the end of last year, is projected to increase to 5.6 percent by 2009.

The forecast rates are historically low: the projected averages for 3-month and 10-year Treasuries during 2006–2016 are lower than the averages for these instruments during each decade of the 1970s, 1980s, and 1990s. The relatively low projected yields are due largely to the relatively low projected inflation rate. Adjusted for inflation, the projected real interest rates are close to their historical averages.

Income Shares: The share of labor compensation in GDP is projected to rise from its low level in 2005, while the share of corporate profits is projected to decline from the unusually high levels of 2005 and those anticipated for 2006. In recent years, growth of labor compensation adjusted for inflation has lagged the growth of productivity. During the projection period, however, labor compensation is expected to catch up, which would raise the labor share in GDP back to about its historical average.

Among the components of labor compensation, the wage share in GDP is expected to rise from its recent low level while the share of supplements to wages and salaries is expected to remain at around the high level reached in 2005. The supplement share in GDP has risen because of rapidly growing health insurance contributions paid by employers and sharply higher employer "catch-up" contributions to defined-benefit pension plans.

Corporate profits before tax jumped sharply as a share of GDP in 2005 primarily because of the end of the accelerated depreciation permitted by the 2002 and 2003 tax acts. Accelerated depreciation lowered profits before tax compared with what they otherwise would have been in 2003 and 2004 by allowing firms to write off more of their investment sooner. After 2004, however, corporate profits before tax will be higher than normal both because new investment will not qualify for the temporary acceleration and because the remaining depreciation permitted on investment that used this provision will be less.

Among the other income components, the share of personal interest income in GDP is projected to decline reflecting the low nominal interest rates of recent years. The remaining shares of the tax base (dividends, rental income, and proprietors' income) are projected to remain relatively stable at around their 2005 levels.

Comparison with CBO and Private-Sector Forecasts

In addition to the Administration, the Congressional Budget Office (CBO) and many private-sector forecasters also make economic projections. CBO develops its projections to aid Congress in formulating budget policy. In the executive branch, this function is performed jointly by the Treasury, the Council of Economic Advisers, and the Office of Management and Budget. Private-sector forecasts are often used by businesses for long-term planning. Table 12–2 compares the 2007 Budget assumptions with projections by CBO and by the Blue Chip Consensus, an average of about 50 private-sector forecasts.

Table 12–2. COMPARISON OF ECONOMIC ASSUMPTIONS

(Calendar years)

	Projections						Average, 2006–11
	2006	2007	2008	2009	2010	2011	
GDP (billions of current dollars):							
2007 Budget	13,210	13,949	14,713	15,493	16,310	17,177	
CBO January	13,263	13,960	14,696	15,455	16,208	16,954	
Blue Chip Consensus January [2]	13,237	13,939	14,703	15,505	16,372	17,280	
Real GDP (chain-weighted): [1]							
2007 Budget	3.4	3.3	3.3	3.1	3.1	3.1	3.2
CBO January	3.6	3.4	3.4	3.3	3.0	2.8	3.3
Blue Chip Consensus January [2]	3.4	3.1	3.2	3.1	3.3	3.2	3.2
Chain-weighted GDP Price Index: [1]							
2007 Budget	2.4	2.2	2.1	2.1	2.1	2.1	2.2
CBO January	2.4	1.8	1.8	1.8	1.8	1.8	1.9
Blue Chip Consensus January [2]	2.4	2.1	2.3	2.2	2.3	2.2	2.3
Consumer Price Index (all-urban): [1]							
2007 Budget	3.0	2.4	2.4	2.4	2.4	2.5	2.5
CBO January	2.8	2.1	2.2	2.2	2.2	2.2	2.3
Blue Chip Consensus January [2]	2.9	2.4	2.5	2.5	2.4	2.5	2.5
Unemployment rate: [3]							
2007 Budget	5.0	5.0	5.0	5.0	5.0	5.0	5.0
CBO January	5.0	5.0	5.1	5.2	5.2	5.2	5.1
Blue Chip Consensus January [2]	4.9	4.9	4.9	4.9	5.0	4.9	4.9
Interest rates: [3]							
91-day Treasury bills:							
2007 Budget	4.2	4.2	4.3	4.3	4.3	4.3	4.3
CBO January	4.5	4.5	4.4	4.4	4.4	4.4	4.4
Blue Chip Consensus January [2]	4.5	4.5	4.4	4.3	4.4	4.4	4.4
10-year Treasury notes: [3]							
2007 Budget	5.0	5.3	5.5	5.6	5.6	5.6	5.4
CBO January	5.1	5.2	5.2	5.2	5.2	5.2	5.2
Blue Chip Consensus January [2]	4.9	5.0	5.3	5.3	5.4	5.4	5.2

Sources: Congressional Budget Office; Blue Chip Economic Indicators, Aspen Publishers, Inc.
[1] Year-over-year percent change.
[2] January 2006 Blue Chip Consensus forecast for 2006 and 2007; Blue Chip October 2005 long-run extension for 2008–2011.
[3] Annual averages, percent.

The three sets of economic assumptions are based on different underlying assumptions concerning economic policies. The Administration forecast generally assumes that the President's Budget proposals will be enacted. In contrast, the CBO baseline projection assumes that current law as of the time the estimates are made remains unchanged. Despite their differing policy assumptions, the three sets of economic projections, shown in Table 12–2, are very close. The similarity of the Budget economic projection to both the CBO baseline projection and the Consensus forecast underscores the conservative nature of the Administration forecast.

For real GDP, the Administration, CBO, and the Blue Chip Consensus anticipate solid growth this year. The Administration projects 3.4 percent growth on a year-over-year basis, the same as the private sector consensus and slightly below CBO's forecast. For calendar year 2007, the Administration, at 3.3 percent, is between the consensus (at 3.1 percent), and CBO's 3.4 percent. Thereafter, the Administration's projection is very close to the consensus growth rate but below CBO's through 2009. Over the six-year span as a whole, the Administration, CBO and the private sector consensus all project 3.2 or 3.3 percent average annual growth rates.

All three forecasts anticipate continued low inflation in the range of 1.8 to 2.4 percent as measured by the GDP price index; and, after 2006, between 2.2 and 2.5 percent as measured by the CPI, with CBO lower than the Administration and the private sector consensus, which are close to each other. The three unemployment rate projections are also similar with a projected rate near 5 percent throughout the forecast. All three project slightly rising interest rates during the next few years, with the Administration's long term rates slightly above the Blue Chip's and CBO's slightly below, and the short term rate forecasts nearly identical.

Changes in Economic Assumptions

The economic assumptions underlying this Budget are similar to those of the 2006 Budget, as shown in Table 12–3.

Real GDP growth is now expected to be 3.4 percent in 2006 on a year-over-year basis compared to 3.5 percent forecast in last year's Budget, and to moderate gradually to 3.1 percent in the outyears. Consequently, the levels of real GDP projected this year are little changed from those of the 2006 Budget when allowance is made for the Commerce Department's historical revisions to the National Income and Product Accounts released in July 2005. The level of nominal GDP is now projected to be higher than in the 2006 Budget because of a faster-than-expected rise in the GDP price index last year and slightly higher projected GDP inflation in the coming years.

The unemployment rate projection is virtually identical to last year's. Where the 2006 Budget had the rate level at 5.1 percent in future years, the rate is now projected to remain at the relatively low average of 5.0 percent recorded for the last nine months of 2005. Interest rates are expected to trend upward, as before. The 3-month Treasury bill rate is now projected to rise to 4.3 percent by 2008, where before it reached that level only in 2011; and the yield on the 10-year Treasury note is expected to rise only to 5.6 percent, not 5.7 percent.

Structural and Cyclical Balances

When the economy is operating below potential, the unemployment rate exceeds the long-run sustainable average consistent with price stability. As a result, receipts are lower than they would be if resources were more fully employed, and outlays for unemployment-sensitive programs (such as unemployment compensation and food stamps) are higher; the deficit is larger (or the surplus is smaller) than would be the case if the unemployment rate were at its sustainable long-run average. The portion of the deficit (or surplus) that can be traced to this factor can be called the cyclical component. The portion that would remain if the unemployment rate was at its long-run value is then called the structural deficit (or structural surplus).

Historically, the structural balance has often provided a clearer understanding of the stance of fiscal policy than has the unadjusted budget balance which includes a cyclical component. In the typical post-World War II business cycle, the structural balance has provided a clearer gauge of the surplus or deficit that would persist in the long run with the economy operating at the sustainable level of unemployment.

Conventional estimates of the structural balance are based on the historical relationship between changes in the unemployment rate and real GDP growth on the one hand, and receipts and outlays on the other. For various reasons, these estimated relationships do not take into account all of the cyclical changes in the economy. One example of a cyclical phenomenon not captured in these estimates was the sharply rising stock market during the second half of the 1990s. It boosted capital gains-related receipts and pulled down the deficit. The subsequent fall in the stock market reduced receipts and added to the deficit. Some of this rise and fall was cyclical in nature. It is not possible, however, to estimate the cyclical component of the stock market accurately, and for that reason, all of the stock market's contribution to receipts is counted in the structural balance.

Other factors unique to the current economic cycle provide other examples of less-than-complete cyclical adjustment. The extraordinary fall-off in labor force participation, from 67.1 percent of the U.S. population in 1997–2000 to 66.0 percent in 2004–2005, appears to be at least partly cyclical in nature, and most forecasters are assuming some rebound in labor force participation as the expansion continues. Since the official unemployment rate does not include workers who have left the labor force, the conventional measures of potential GDP, incomes, and Government receipts understate the extent to which potential work hours have been

Table 12–3. COMPARISON OF ECONOMIC ASSUMPTIONS IN THE 2006 AND 2007 BUDGETS

(Calendar years; dollar amounts in billions)

	2005	2006	2007	2008	2009	2010	2011
Nominal GDP:							
2006 Budget assumptions [1]	12,401	13,093	13,808	14,548	15,318	16,124	16,976
2007 Budget assumptions	12,482	13,210	13,949	14,713	15,493	16,310	17,177
Real GDP (2000 dollars):							
2006 Budget assumptions [1]	11,149	11,540	11,922	12,303	12,688	13,081	13,487
2007 Budget assumptions	11,139	11,514	11,896	12,284	12,669	13,062	13,467
Real GDP (percent change): [2]							
2006 Budget assumptions	3.6	3.5	3.3	3.2	3.1	3.1	3.1
2007 Budget assumptions	3.6	3.4	3.3	3.3	3.1	3.1	3.1
GDP price index (percent change): [2]							
2006 Budget assumptions	2.0	2.0	2.1	2.1	2.1	2.1	2.1
2007 Budget assumptions	2.7	2.4	2.2	2.1	2.1	2.1	2.1
Consumer Price Index (percent change): [2]							
2006 Budget assumptions	2.0	2.3	2.4	2.4	2.4	2.4	2.5
2007 Budget assumptions	3.4	3.0	2.4	2.4	2.4	2.4	2.5
Civilian unemployment rate (percent): [3]							
2006 Budget assumptions	5.3	5.2	5.1	5.1	5.1	5.1	5.1
2007 Budget assumptions	5.1	5.0	5.0	5.0	5.0	5.0	5.0
91-day Treasury bill rate (percent): [3]							
2006 Budget assumptions	2.7	3.5	3.8	4.0	4.1	4.2	4.3
2007 Budget assumptions	3.2	4.2	4.2	4.3	4.3	4.3	4.3
10-year Treasury note rate (percent): [3]							
2006 Budget assumptions	4.6	5.2	5.4	5.5	5.6	5.6	5.7
2007 Budget assumptions	4.3	5.0	5.3	5.5	5.6	5.6	5.6

[1] Adjusted for July 2005 NIPA revisions.
[2] Year-over-year.
[3] Calendar year average.

under-utilized in the current expansion to date because of the decline in labor force participation.

A third example is the fall-off in the wage and salary share of GDP, from 49.2 percent in 2000 to 45.6 percent in the second quarter of 2004. Again, this change is widely suspected to be partly cyclical. Since Federal taxes depend heavily on wage and salary income, the larger-than-predicted decline in the wage share of GDP suggests that the true cyclical component of the deficit is understated for this reason as well.

There are also lags in the collection of tax revenue that can delay the impact of cyclical effects beyond the year in which they occur. The result is that even after the unemployment rate has fallen, receipts may remain cyclically depressed for some time until these lagged effects have dissipated.

For all these reasons, the current estimates of the cyclical deficit are probably understated. The current unemployment gap is believed to be zero, and the Administration forecasts that it will remain so, but in the broader sense discussed above, the cyclical gap in receipts is likely to still be large and only slowly shrinking.

During fiscal years 2000 and 2001, the unemployment rate appears to have been lower than could be sustained in the long run. Therefore, as shown in Table 12–4, in those years the structural surplus was smaller than the actual surplus, which was enlarged by the boost to receipts and the reduction in outlays associated with the low level of unemployment.

Table 12–4. ADJUSTED STRUCTURAL BALANCE

(In billions of dollars)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Unadjusted surplus or deficit (–)	236.2	128.2	–157.8	–377.6	–412.7	–318.3	–423.2	–354.2	–223.3	–207.6	–182.7	–204.9
Cyclical component	134.6	80.8	–47.0	–91.4	–51.6	–19.3	–5.0	–0.8	....	....	....	....
Structural surplus or deficit (–)	101.6	47.5	–110.8	–286.2	–361.2	–299.0	–418.2	–353.4	–223.3	–207.6	–182.7	–204.9
Deposit insurance outlays	3.1	1.6	1.0	1.4	2.0	1.4	1.3	1.8	1.8	1.7	2.8	3.7
Adjusted structural surplus or deficit (–)	104.7	49.0	–109.8	–284.8	–359.2	–297.6	–416.9	–351.6	–221.5	–205.8	–179.9	–201.2

NOTE: The NAIRU is assumed to be 5.0 percent

Sensitivity of the Budget to Economic Assumptions

Both receipts and outlays are affected by changes in economic conditions. This sensitivity complicates budget planning because errors in economic assumptions lead to errors in the budget projections. It is therefore useful to examine the implications of possible changes in economic assumptions. Many of the budgetary effects of such changes are fairly predictable, and a set of rules of thumb embodying these relationships can aid in estimating how changes in the economic assumptions would alter outlays, receipts, and the surplus or deficit. These rules of thumb should be understood as suggesting orders of magnitude; they ignore a long list of secondary effects that are not captured in the estimates.

Economic variables that affect the budget do not usually change independently of one another. Output and employment tend to move together in the short run: a high rate of real GDP growth is generally associated with a declining rate of unemployment, while slow or negative growth is usually accompanied by rising unemployment. In the long run, however, changes in the average rate of growth of real GDP are mainly due to changes in the rates of growth of productivity and the labor force, and are not necessarily associated with changes in the average rate of unemployment. Inflation and interest rates are also closely interrelated: a higher expected rate of inflation increases interest rates, while lower expected inflation reduces interest rates.

Changes in real GDP growth or inflation have a much greater cumulative effect on the budget over time if they are sustained for several years than if they last for only one year. Highlights of the budgetary effects of the above rules of thumb are shown in Table 12–5.

For real growth and employment:

- As shown in the first block, if in 2006 for one year only, real GDP growth is lower by one percentage point and the unemployment rate permanently rises by one-half percentage point relative to the budget assumptions, the fiscal year 2006 deficit is estimated to increase by $15.8 billion; receipts in 2006 would be lower by $12.6 billion, and outlays would be higher by $3.2 billion, primarily for unemployment-sensitive programs. In fiscal year 2007, the estimated receipts shortfall would grow further to $26.6 billion, and outlays would increase by $8.9 billion relative to the base, even though the growth rate in calendar year 2007 equaled the rate originally assumed. This is because the level of real (and nominal) GDP and taxable incomes would be permanently lower, and unemployment permanently higher. The budget effects (including growing interest costs associated with larger deficits) would continue to grow slightly in each successive year. During 2006–2011, the cumulative increase in the budget deficit is estimated to be $236 billion.
- The budgetary effects are much larger if the real growth rate is permanently reduced by one percentage point and the unemployment rate is unchanged, as shown in the second block. This scenario might occur if trend productivity were permanently lowered. In this example, during 2006–2011, the cumulative increase in the budget deficit is estimated to be $662 billion.
- The third block shows the effect of a one percentage point higher rate of inflation and one percentage point higher interest rates during calendar year 2006 only. In subsequent years, the price level and nominal GDP would be one percent higher than in the base case, but interest rates and future inflation rates are assumed to return to their base levels. In 2006 and 2007, outlays would be above the base by $11.2 billion and $19.3 billion, respectively, due in part to lagged cost-of-living adjustments. Receipts would rise by only $16.6 billion in 2006, due to the temporary effect of higher interest rates on financial corporations' profits and taxes, but then would rise by $44.4 billion above the base in 2007 due to the sustained effects of inflation on the tax base, resulting in a $25.1 billion improvement in the 2007 budget balance. In subsequent years, the amounts added to receipts would continue to be larger than the additions to outlays. During 2006–2011, cumulative budget deficits would be $123 billion smaller than in the base case.
- In the fourth block example, the rate of inflation and the level of interest rates are higher by one percentage point in all years. As a result, the price level and nominal GDP rise by a cumulatively growing percentage above their base levels. In this case, the effects on receipts and outlays mount steadily in successive years, adding $362 billion to outlays over 2006–2011 and $783 billion to receipts, for a net decrease in the 2006–2011 deficits of $421 billion.
- The outlay effects of a one percentage point increase in interest rates alone are shown in the fifth block. The receipts portion of this rule-of-thumb is due to the Federal Reserve's deposit of earnings on its securities portfolio and the effect of interest rate changes on financial corporations' profits (and taxes).
- The sixth block shows that a sustained one percentage point increase in the GDP price index and in CPI inflation decrease cumulative deficits by a substantial $429 billion during 2006–2011. This large effect is because the receipts from a higher tax base exceed the combination of higher outlays from mandatory cost-of-living adjustments and lower receipts from CPI indexation of tax brackets. The separate effects of higher inflation and higher interest rates in the fifth and sixth blocks do not sum to the effects for simultaneous changes in both in the fourth block. This occurs largely because the gains in budget receipts due to higher inflation result in higher debt service savings when interest rates are assumed to be higher as

well (the combined case) than when interest rates are assumed to be unchanged (the separate case).

The last entry in the table shows rules of thumb for the added interest cost associated with changes in the budget deficit.

The effects of changes in economic assumptions in the opposite direction are approximately symmetric to those shown in the table. The impact of a one percentage point lower rate of inflation or higher real growth would have about the same magnitude as the effects shown in the table, but with the opposite sign.

Table 12–5. SENSITIVITY OF THE BUDGET TO ECONOMIC ASSUMPTIONS

(Fiscal years; in billions of dollars)

Budget effect	2006	2007	2008	2009	2010	2011	Total of Effects, 2006–2011
Real Growth and Employment							
Budgetary effects of 1 percent lower real GDP growth:							
(1) For calendar year 2006 only: [1]							
Receipts	–12.6	–26.6	–30.2	–32.1	–34.2	–36.3	–172.1
Outlays	3.2	8.9	9.8	11.9	14.0	16.2	64.0
Increase in deficit (–)	–15.8	–35.5	–39.9	–44.0	–48.3	–52.5	–236.0
(2) Sustained during 2006–2011, with no change in unemployment:							
Receipts	–12.8	–41.8	–77.7	–117.3	–161.5	–209.8	–620.8
Outlays	0.2	1.0	3.3	7.3	12.0	17.8	41.5
Increase in deficit (–)	–12.9	–42.8	–80.9	–124.5	–173.5	–227.6	–662.3
Inflation and Interest Rates							
Budgetary effects of 1 percentage point higher rate of:							
(3) Inflation and interest rates during calendar year 2006 only:							
Receipts	16.6	44.4	40.2	32.8	35.0	37.1	206.1
Outlays	11.2	19.3	14.6	13.3	12.9	12.3	83.5
Decrease in deficit (+)	5.4	25.1	25.7	19.6	22.1	24.8	122.6
(4) Inflation and interest rates, sustained during 2006–2011:							
Receipts	16.6	65.2	111.6	151.6	194.6	243.3	783.0
Outlays	11.7	35.2	54.0	70.4	86.9	103.8	361.9
Decrease in deficit (+)	4.9	30.0	57.7	81.3	107.7	139.5	421.0
(5) Interest rates only, sustained during 2006–2011:							
Receipts	3.9	24.1	36.5	38.9	39.2	40.6	183.3
Outlays	8.6	24.4	34.2	40.3	45.4	49.7	202.8
Increase in deficit (–)	–4.7	–0.3	2.2	–1.4	–6.2	–9.2	–19.5
(6) Inflation only, sustained during 2006–2011:							
Receipts	12.6	41.0	74.9	112.4	154.9	202.2	598.2
Outlays	3.1	11.1	20.5	31.6	44.2	58.3	168.8
Decrease in deficit (+)	9.5	29.9	54.4	80.8	110.8	143.9	429.4
Interest Cost of Higher Federal Borrowing							
(7) Outlay effect of $100 billion increase in borrowing in 2006	2.2	4.6	4.9	5.2	5.5	5.8	28.2

[1] The unemployment rate is assumed to be 0.5 percentage point higher per 1.0 percent shortfall in the level of real GDP.

13. STEWARDSHIP

Introduction

The budget is an essential tool for allocating resources within the Federal Government and between the public and private sectors, but current outlays, receipts, and the deficit give at best a partial picture of the Government's financial condition. Indeed, changes in the annual budget deficit or surplus can be misleading. For example, the temporary shift from annual deficits to surpluses in the late 1990s did nothing to correct the long-term fiscal deficiencies in the major entitlement programs, which are the major source of the long-run shortfall in Federal finances. This would have been more apparent at the time if greater attention had been focused on long-term measures such as those presented in this chapter. As important as the current budget surplus or deficit is, other indicators are also needed to judge the Government's fiscal condition.

For the Federal Government, unfortunately, there is no single number that corresponds to a business's bottom line. The Government is judged by how its actions affect the country's security and well-being, and that cannot easily be summed up with a single statistic. Also, even though its financial condition is important, the Government is not expected to earn a profit. Its financial status is best evaluated using a broad range of data and several complementary perspectives. This chapter presents a framework for such analysis. Because there are serious limitations on the available data and the future is uncertain, this chapter's findings should be interpreted with caution; its conclusions are subject to future revision.

The chapter consists of four parts:

- Part I explains how the separate pieces of analysis link together. Chart 13–1 is a schematic diagram showing the linkages.
- Part II presents estimates of the Government's assets and liabilities, which are shown in Table 13–1. This table is similar to a business balance sheet, but for that reason it cannot reveal some of the Government's unique financial features and needs to be supplemented by the information in Parts III and IV.
- Part III shows possible long-run paths for the Federal budget. These projections vary depending on alternative economic and demographic assumptions. The projections are summarized in Table 13–2 and in a related set of charts. Table 13–3 shows present value estimates of the funding shortfall in Social Security and Medicare. Together these data indicate the scope of the Government's future responsibilities and the resources it will have available to discharge them under current law and policy. In particular, they show the looming long-run fiscal challenge posed by the Federal entitlement programs.
- Part IV returns the focus to the present. It presents information on national economic and social conditions. The private economy is the ultimate source of the Government's resources. Table 13–4 gives a summary of total national wealth, while highlighting the Federal investments that have contributed to that wealth. Table 13–5 shows trends in wealth and Table 13–6 presents a small sample of statistical indicators.

PART I—A FRAMEWORK TO EVALUATE FEDERAL FINANCES

No single framework can encompass all of the factors that affect the financial condition of the Federal Government, but the framework presented here is reasonably comprehensive and it offers a useful way to examine the financial implications of Federal policies. This framework includes balance-sheet information, but it also includes long-run projections of the entire budget showing where future fiscal strains are most likely to appear. It includes measures of national wealth, which support future income and tax receipts, and an array of economic and social indicators showing potential pressure points that may require future policy responses.

The Government's legally binding obligations—its liabilities—consist in the first place of Treasury debt. Other liabilities include the pensions and medical benefits owed to retired Federal employees and veterans. These employee obligations are a form of deferred compensation; they have counterparts in the business world, and would appear as liabilities on a business balance sheet. Accrued obligations for Government insurance policies and the estimated present value of failed loan guarantees and deposit insurance claims are also analogous to private liabilities. These Government liabilities are discussed further in Part II along with the Government's assets. The liabilities and assets are collected in Table 13–1. The liabilities shown in Table 13–1 are only a subset of the Government's overall financial responsibilities. Indeed, the full extent of the Government's fiscal exposure through programmatic commitments dwarfs the outstanding total of all acknowledged Federal liabilities. The commitments to Social Security and Medicare alone amount to many times the value of Federal debt held by the public.

In addition to Social Security and Medicare, the Government has a broad range of programs that dispense cash and other benefits to individual recipients. A few examples of such programs are Medicaid, food stamps, veterans' pensions and health care. The Government also provides a wide range of public services that must be financed through the tax system. It is true that specific programs may be modified or even ended at any time by the Congress and the President, and changes in the laws governing these programs are a regular part of the legislative cycle. For this reason, these programmatic commitments do not constitute "liabilities" in a legal or accounting sense, and they would not appear on a balance sheet. They are Federal responsibilities, however, and will have a claim on budgetary resources for the foreseeable future. All of the Government's existing programs are reflected in the long-run budget projections in Part III. It would be misleading to leave out any of these programmatic commitments in projecting future claims on the Government or in calculating the Government's long-run fiscal balance.

The Federal Government has many assets. These include financial assets, such as loans and mortgages which have been acquired through various credit programs. They also include the plant and equipment used to produce Government services. The Government also owns a substantial amount of land. Such assets would normally be shown on a balance sheet. The Government also has resources in addition to those that might be expected to appear on a balance sheet. These additional resources include most importantly the Government's sovereign power to tax.

Because of its unique responsibilities and resources, the most revealing way to analyze the future strains on the Government's fiscal position is to make a long-run projection of the entire Federal budget. Part III of this chapter presents a set of such projections under different assumptions about policy and future economic and demographic conditions. Over long periods of time, the spending of the Government must be financed by the taxes and other receipts it collects. Although the Government can borrow for temporary periods, it must pay interest on any such borrowing, which adds to future spending. In the long run, a solvent Government must pay for its spending out of its receipts. The projections in Part III show that under an extension of the estimates in this Budget, long-run balance in this sense is not achieved, mostly because projected spending for Social Security, Medicare, and Medicaid grow faster than the revenue available to pay for them.

The long-run budget projections and the table of assets and liabilities are silent on the question of whether the public is receiving value for its tax dollars or whether Federal assets are being used effectively. Information on those points requires performance measures for Government programs supplemented by appropriate information about conditions in the economy and society. Recent changes in budgeting practices have contributed to the goal of providing more information about Government programs and will permit a closer alignment of the cost of programs with performance measures. These changes have been described in detail in previous Budgets. They are reviewed in chapter 2 of this volume, and in the accompanying material that describes results obtained with the Program Assessment Rating Tool (PART). This Stewardship chapter complements the detailed exploration of Government performance with an assessment of the overall impact of Federal policy as reflected in general measures of economic and social well-being, shown in Table 13–6.

Relationship with FASAB Objectives

The framework presented here meets the stewardship objective for Federal financial reporting recommended by the Federal Accounting Standards Advisory Board (FASAB) and adopted for use by the Federal Government in September 1993. [1]

> *Federal financial reporting should assist report users in assessing the impact on the country of the government's operations and investments for the period and how, as a result, the government's and the Nation's financial conditions have changed and may change in the future. Federal financial reporting should provide information that helps the reader to determine:*
>
> *3a. Whether the government's financial position improved or deteriorated over the period.*
>
> *3b. Whether future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due.*
>
> *3c. Whether government operations have contributed to the nation's current and future well-being.*

The presentation here is an experimental approach for meeting this objective at the Government-wide level. It is intended to meet the broad interests of economists and others in evaluating trends over time, including both past and future trends. The annual Financial Report of the United States Government presents related information, but from a different perspective. The Financial Report includes a balance sheet. The assets and liabilities on that balance sheet are all based on transactions and other events that have already occurred. A similar table can be found in Part II of this chapter but based on different data and methods of valuation. The Financial Report also includes a statement of social insurance that reviews a substantial body of information on the condition and sustainability of the Government's social insurance programs. The Report, however, does not extend that review to the condition or sustainability of the Government as a whole, which is a main focus of this chapter, and it does not try to relate the Government's assets and liabilities to private wealth or broader economic and social conditions.

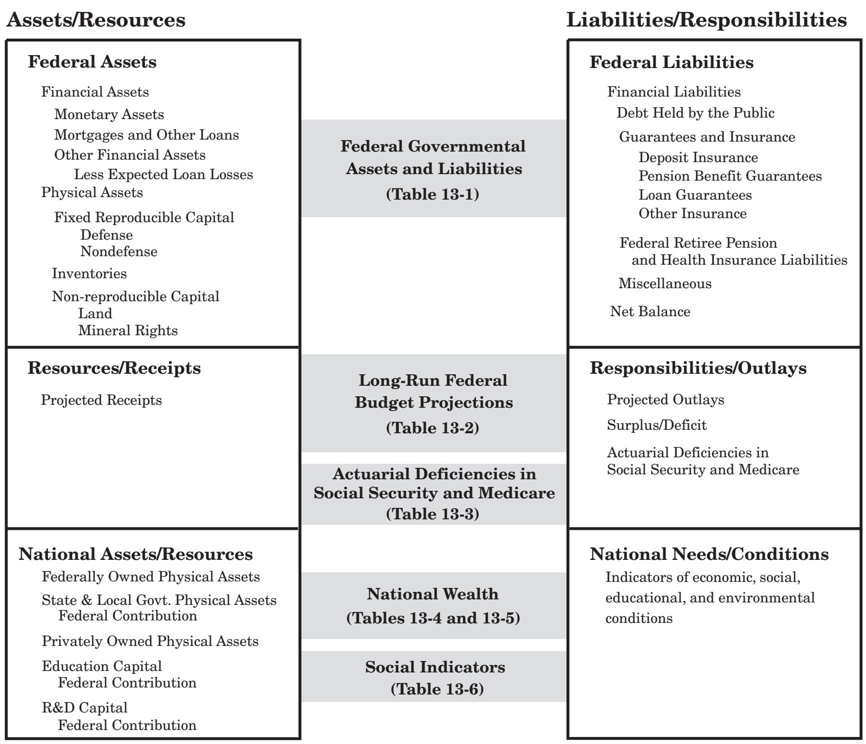
Connecting the Dots: The presentation that follows is constructed around a series of tables and charts. The schematic diagram, Chart 13–1, shows how the different pieces fit together. The tables and charts should be viewed as an ensemble, the main elements

[1] Statement of Federal Financial Accounting Concepts, Number 1, Objectives of Federal Financial Reporting, September 2, 1993. Other objectives are budgetary integrity, operating performance, and systems and controls. .

of which are grouped in two broad categories—assets/resources and liabilities/responsibilities.

- The left-hand side of Chart 13–1 shows the full range of Federal resources, including assets the Government owns, tax receipts it can expect to collect given current and proposed law, and national wealth, including the trained skills of the national work force, that provide the base for Government revenues.
- The right-hand side reveals the full range of Federal obligations and responsibilities, beginning with the Government's acknowledged liabilities from past actions, such as the debt held by the public, and including future budget outlays needed to maintain present policies and trends. This column ends with a set of indicators highlighting areas where Government activity affects society or the economy.

Chart 13-1. The Financial Condition of the Federal Government and the Nation



QUESTIONS AND ANSWERS ABOUT THE GOVERNMENT'S STEWARDSHIP

1. According to Table 13–1, the Government's liabilities exceed its assets. No business could operate in such a fashion. Why does the Government not manage its finances more like a business?

The Federal Government has different objectives from a business firm. The goal of every business is to earn a profit, and as a general rule the Federal Government properly leaves activities at which a profit could be earned to the private sector. For the vast bulk of the Federal Government's operations, it would be difficult or impossible to charge prices that would even cover all its expenses. The Government undertakes these activities not to improve its balance sheet, but to benefit the Nation.

For example, the Government invests in education and research, but it earns no direct return from these investments. People are enriched by these investments, but the returns do not show up as an increase in Government assets rather as an increase in the general state of knowledge and in the capacity of the country's citizens to earn a living and lead a fuller life. Business investment motives are quite different; business invests to earn a profit for itself, not others, and if its investments are successful, their value will be reflected in its balance sheet. Because the Federal Government's objectives are different, its balance sheet behaves differently, and should be interpreted differently.

2. Table 13–1 seems to imply that the Government is insolvent. Is it?

No. Just as the Federal Government's responsibilities are different from those of private business, so are its resources. Government solvency must be evaluated in different terms.

What Table 13–1 shows is that those Federal obligations that are most comparable to the liabilities of a business corporation exceed the estimated value of the assets actually owned by the Federal Government. The Government, however, has access to other resources through its sovereign powers. These powers, which include taxation, will allow the Government to meet its present obligations and those that are anticipated from future operations even though the Government's current assets are less than its current liabilities.

Private financial markets clearly recognize this reality. The Federal Government's implicit credit rating is among the best in the world; lenders are willing to lend it money at interest rates substantially below those charged to private borrowers. This would not be true if the Government were really insolvent or likely to become so. Where governments totter on the brink of insolvency, lenders are either unwilling to lend them money, or do so only in return for a substantial interest premium.

QUESTIONS AND ANSWERS ABOUT THE GOVERNMENT'S STEWARDSHIP

3. Why are Social Security and Medicare not shown as Government liabilities in Table 13–1?

Future Social Security and Medicare benefits may be considered as promises or responsibilities of the Federal Government, but these benefits are not a liability in a legal or accounting sense. The Government has unilaterally decreased as well as increased these benefits in the past, and future reforms could alter them again. These benefits are reflected in this presentation of the Government's finances, but they are shown elsewhere than in Table 13–1. They appear in two ways: as part of the overall budget projections in Table 13–2, and in the actuarial deficiency estimates in Table 13–3.

Other Federal programs make similar promises to those of Social Security and Medicare—Medicaid, for example. Few have suggested counting future benefits expected under these programs as Federal liabilities, yet it would be difficult to justify a different accounting treatment for them if Social Security or Medicare were to be classified as a liability. There is no bright line dividing Social Security and Medicare from other programs that promise benefits to people, and all the Government programs that do so should be accounted for similarly.

Also, if Social Security and Medicare benefits were treated as liabilities, then payroll tax receipts earmarked to finance those benefits ought to be treated as assets. This treatment would be essential to gauge the size of the future claim. Tax receipts, however, are not generally considered to be Government assets, and for good reason: the Government does not own the wealth on which future taxes depend. Including taxes on the balance sheet would be wrong for this reason, but without counting taxes the balance sheet would overstate the drain on net assets from Social Security and Medicare benefits. Furthermore, treating taxes for Social Security or Medicare differently from other taxes would be highly questionable.

Finally, under Generally Accepted Accounting Principles (GAAP), Social Security is not considered to be a liability, so not counting it as such in this chapter is consistent with accounting standards.

4. Why doesn't the Federal Government follow normal business practice in its bookkeeping?

The Government is not a business, and accounting standards designed to illuminate how much a business earns and how much equity it has could provide misleading information if applied naively to the Government. The Government does not have a "bottom line" comparable to that of a business corporation, but the Federal Accounting Standards Advisory Board (FASAB) has developed, and the Government has adopted, a conceptual accounting framework that reflects the Government's distinct functions and answers many of the questions for which Government should be accountable. This framework addresses budgetary integrity, operating performance, stewardship, and systems and controls. FASAB has also developed, and the Government has adopted, a full set of accounting standards. Federal agencies now issue audited financial reports that follow these standards and an audited Government-wide financial report is issued as well. In short, the Federal Government does follow generally accepted accounting principles (GAAP) just as businesses and State and local governments do, although the relevant principles differ depending on the circumstances. This chapter is intended to address the "stewardship objective"—assessing the interrelated condition of the Federal Government and the Nation. The data in this chapter illuminate the trade-offs and connections between making the Federal Government "better off" and making the Nation "better off."

QUESTIONS AND ANSWERS ABOUT THE GOVERNMENT'S STEWARDSHIP

5. When the baby boom generation retires, the deficit could become much larger than it ever was before. How is this reflected in the current evaluation of the Government's financial condition?

The aging of the population will become dramatically evident when the baby boomers begin to retire, and this demographic transition poses serious long-term problems for Federal entitlement programs and the budget. Both the long-range budget projections shown in this chapter and the actuarial projections prepared for Social Security and Medicare indicate how serious the problem is. It is clear from this information that reforms are needed in these programs to meet the long-term challenges.

6. Does it make sense for the Government to finance needed capital by borrowing, which would permit a deficit in the budget, so long as the borrowing did not exceed the amount spent on investments?

This rule might not permit much extra borrowing. Even if the Government financed new capital by borrowing, it would need to pay off the debt incurred in this way as the capital was used up. Only the net investment the Government does after subtracting capital consumption would be financed with a net increase in borrowing. As discussed in Chapter 6, recently Federal net investment in physical capital has not been very large and occasionally it has even been negative, so little if any deficit spending would have been justified by this borrowing-for-investment criterion, at least in recent years.

The Federal Government also funds substantial amounts of physical capital that it does not own, such as highways and research facilities, and it funds investment in intangible "capital" such as education and training and the conduct of research and development. A private business would never borrow to spend on assets that would be owned by someone else. However, such spending is today a principal function of the Federal Government. It is not clear whether this type of capital investment would fall under the borrowing-for-investment criterion, even though they are an important part of national wealth.

There is another difficulty with the logic of borrowing to invest. Businesses expect investments to earn a return large enough to cover their cost. In contrast, the Federal Government does not generally expect to receive a direct payoff from its investments, whether or not it owns them. In this sense, investments are no different from other Government expenditures, and the fact that they provide services over a longer period of time is no justification for excluding them when calculating the surplus or deficit.

Finally, the Federal Government pursues policies that support the overall economic well-being of the Nation and its security interests. For such reasons, the Government may deem it desirable to run a budget surplus, even if this means paying for its own investments from current receipts, and there will be other times when it is necessary to run a deficit, even one that exceeds Government net investment. Considerations in addition to the size of Federal investment must be weighed in choosing the right level of the surplus or deficit.

PART II—THE FEDERAL GOVERNMENT'S ASSETS AND LIABILITIES

Table 13–1 takes a backward look at the Government's assets and liabilities summarizing what the Government owes as a result of its past operations netted against the value of what it owns. The table gives some perspective by showing these net asset figures for a number of years beginning in 1960. To ensure comparability across time, the assets and liabilities are measured in terms of constant FY 2005 dollars and the balance is also shown as a ratio to GDP. Government liabilities have exceeded the value of assets (see chart 13–2) over this entire period, but, in the late 1970s, a speculative run-up in the prices of oil and other real assets temporarily boosted the value of Federal holdings. When those prices subsequently declined, real Federal asset values declined and only recently have they regained the level they had reached in the mid-1980s.

Chart 13-2. Net Federal Liabilities

Currently, the total real value of Federal assets is estimated to be 77 percent greater than it was in 1960. Meanwhile, Federal liabilities have increased by 244 percent in real terms. The decline in the Federal net asset position has been partly due to persistent Federal budget deficits that have boosted debt held by the public most years since 1960. Other factors have also been important such as large increases in health benefits promised for Federal retirees and the sharp rise in veterans' disability compensation. The relatively slow growth in Federal asset values also helped reduce the net asset position.

The shift from budget deficits to budget surpluses in the late 1990s temporarily checked the decline in Federal net assets. Currently, the net excess of liabilities over assets is about $5.7 trillion or about $19,000 per capita. As a ratio to GDP, the excess of liabilities over assets reached a peak of 52 percent in 1993; it declined to 38 percent in 2000; it rose to 46 percent in 2003; and it has declined slightly since then to around 45 percent of GDP at the end of 2005. The average since 1960 has been 36 percent (see Table 13–1).

Assets

Table 13–1 offers a comprehensive list of the financial and physical resources owned by the Federal Government.

Financial Assets: According to the Federal Reserve Board's Flow-of-Funds accounts, the Federal Government's holdings of financial assets amounted to $0.6 trillion at the end of 2005. Government-held mortgages (measured in constant dollars) reached a peak in the early 1990s as the Government acquired mortgages from savings and loan institutions that had failed. The Government subsequently liquidated most of the mortgages it acquired from these bankrupt savings and loans. Meanwhile, Government holdings of other loans

Table 13–1. GOVERNMENT ASSETS AND LIABILITIES*

(As of the end of the fiscal year, in billions of 2005 dollars)

	1960	1965	1970	1975	1980	1985	1990	1995	2000	2003	2004	2005
ASSETS												
Financial Assets:												
Cash and Checking Deposits	46	67	42	34	52	34	46	47	63	56	56	23
Other Monetary Assets	2	1	1	1	2	2	2	1	7	10	2	2
Mortgages	30	29	43	45	83	85	108	75	86	78	76	76
Other Loans	111	152	190	190	247	320	227	174	145	124	121	117
less Expected Loan Losses	–1	–3	–5	–10	–19	–19	–21	–27	–42	–50	–48	–41
Other Treasury Financial Assets	67	84	73	66	93	137	219	263	240	326	320	338
Subtotal	254	330	344	326	458	559	580	543	572	645	623	608
Nonfinancial Assets:												
Fixed Reproducible Capital:	1,112	1,104	1,148	1,114	1,055	1,193	1,237	1,244	1,091	1,072	1,079	1,106
Defense	959	901	910	832	747	868	891	870	712	674	680	697
Nondefense	153	203	238	282	308	325	346	373	379	398	399	408
Inventories	291	252	235	210	259	297	263	202	208	255	269	272
Nonreproducible Capital	471	483	463	686	1,100	1,179	931	701	1,043	1,220	1,434	1,774
Land	102	142	179	283	361	375	386	293	448	535	611	729
Mineral Rights	369	342	285	404	739	804	545	408	595	684	823	1,045
Subtotal	1,874	1,839	1,846	2,010	2,414	2,668	2,431	2,147	2,342	2,546	2,782	3,152
Total Assets	2,128	2,169	2,190	2,336	2,872	3,228	3,012	2,690	2,914	3,191	3,406	3,760
LIABILITIES												
Debt held by the Public	1,269	1,305	1,161	1,180	1,467	2,426	3,306	4,394	3,826	4,133	4,418	4,590
Insurance and Guarantee Liabilities:												
Deposit Insurance	…………	…………	…………	…………	2	10	80	5	1	1	1	1
Pension Benefit Guarantee	…………	…………	…………	48	35	48	48	23	45	75	91	82
Loan Guarantees	*	1	3	7	14	12	17	33	42	38	44	48
Other Insurance	35	31	24	22	30	18	22	20	18	17	16	16
Subtotal	35	32	27	77	81	89	167	81	106	131	152	147
Pension and Post-Employment Health Liabilities:												
Civilian and Military Pensions	958	1,205	1,440	1,632	2,051	2,035	1,989	1,928	1,978	2,038	2,127	2,169
Retiree Health Insurance Benefits	225	283	338	383	481	477	467	452	438	980	1,020	1,125
Veterans Disability Compensation	211	265	317	351	360	297	268	293	620	1,008	951	1,123
Subtotal	1,394	1,752	2,095	2,366	2,892	2,809	2,723	2,673	3,036	4,026	4,098	4,416
Other Liabilities:												
Trade Payables and Miscellaneous	30	37	47	59	91	119	164	136	111	170	179	183
Benefits Due and Payable	23	27	37	39	49	55	65	76	87	106	106	117
Subtotal	53	64	84	98	140	174	229	212	198	276	285	301
Total Liabilities	2,751	3,153	3,366	3,721	4,580	5,498	6,425	7,359	7,166	8,566	8,952	9,454
Net Assets (Assets Minus Liabilities)	–623	–985	–1,176	–1,385	–1,708	–2,270	–3,414	–4,669	–4,253	–5,376	–5,547	–5,694
Addenda:												
Net Assets Per Capita (in 2005 dollars)	–3,452	–5,076	–5,744	–6,422	–7,488	–9,506	–13,622	–17,489	–15,037	–18,445	–18,846	–19,163
Ratio to GDP (in percent)	–22.1	–27.8	–27.8	–28.9	–29.7	–33.1	–42.6	–51.5	–38.4	–45.9	–45.6	–45.2

* This table shows assets and liabilites for the Government as a whole excluding the Federal Reserve System. Data for 2005 are extrapolated in some cases.

have been declining in real terms since the mid-1980s. The face value of mortgages and other loans overstates their economic worth. OMB estimates that the discounted present value of future losses and interest subsidies on these loans was around $50 billion as of year-end 2005. These estimated losses are subtracted from the face value of outstanding loans to obtain a better estimate of their economic worth.

Reproducible Capital: The Federal Government is a major investor in physical capital and computer software. Government-owned stocks of such capital have amounted to about $1.1 trillion in constant dollars for most of the last 45 years (OMB estimate). This capital consists of defense equipment and structures, including weapons systems, as well as nondefense capital goods. Currently, less than two-thirds of the capital is defense equipment or structures. In 1960, defense capital was over 90 percent of the total. In the 1970s, there was a substantial decline in the real value of U.S. defense capital and there was another large decline in the 1990s after the end of the Cold War. Meanwhile, nondefense Federal capital has increased at an average annual rate of around 2¼ percent. The Government also holds inventories of defense goods and other items that in 2005 amounted to about 25 percent of the value of its fixed capital.

Nonreproducible Capital: The Government owns significant amounts of land and mineral deposits. There are no official estimates of the market value of these holdings (and of course, in a realistic sense, many of these resources would never be sold). Researchers in the private sector have estimated what they are worth, however, and these estimates are extrapolated in Table 13–1. Private land values fell sharply in the early 1990s, but they have risen since 1993. It is assumed here that Federal land shared in the decline and the subsequent recovery. Oil prices have been on a roller coaster since the mid-1990s. They declined sharply in 1997–1998, rebounded in 1999–2000, fell again in 2001, and rose substantially in 2002–2005. These fluctuations have caused the estimated value of Federal mineral deposits to fluctuate as well. In 2005 as estimated here, the combined real value of Federal land and mineral rights was higher than it has ever been, but only 30 percent greater than in 1982. These estimates omit some valuable assets owned by the Federal Government, such as works of art and historical artifacts partly because such unique assets are unlikely ever to be sold and partly because there is no comprehensive inventory or realistic basis for valuing them.

Total Assets: The total value of Government assets measured in constant dollars has risen sharply in the past three years, and was higher in 2005 than ever before. The Government's asset holdings are vast. As of the end of 2005, Government assets were estimated to be worth about $3.8 trillion or 30 percent of GDP.

Liabilities

Table 13–1 includes all Federal liabilities that would normally be listed on a balance sheet. All the various forms of publicly held Federal debt are counted, as are Federal pension and health insurance obligations to civilian and military retirees including the disability compensation that is owed the Nation's veterans, which can be thought of as a form of deferred compensation. The estimated liabilities stemming from Federal insurance programs and loan guarantees are also shown. The benefits that are due and payable under various Federal programs are also included, but these liabilities reflect only binding short-term obligations, not the Government's full commitment under these programs.

Future benefit payments that are promised through Social Security and other Federal income transfer programs are not Federal liabilities in a legal or accounting sense. They are Federal responsibilities, however, and it is important to gauge their size, but they are not binding in the same way as a legally enforceable claim would be. The budget projections and other data in Part III are designed to provide a sense of these broader responsibilities and their claim on future budgets.

Debt Held by the Public: The Federal Government's largest single financial liability is the debt owed to the public. It amounted to about $4.6 trillion at the end of 2005. Publicly held debt declined for several years in the late 1990s because of the unified budget surpluses that emerged at that time, but as deficits returned, publicly held debt began to increase again.

Insurance and Guarantee Liabilities: The Federal Government has contingent liabilities arising from the loan guarantees it has made and from its insurance programs. When the Government guarantees a loan or offers insurance, cash disbursements are often small initially, and if a fee is charged the Government may even collect money; but the risk of future cash payments associated with such commitments can be large. The figures reported in Table 13–1 are estimates of the current discounted value of prospective future losses on outstanding guarantees and insurance contracts. The present value of all such losses taken together is about $0.1 trillion. As is true elsewhere in this chapter, this estimate does not incorporate the market value of the risk associated with these contingent liabilities; it merely reflects the present value of expected losses. Although individually many of these programs are large and potential losses can be a serious concern, relative to total Federal liabilities or even the total debt held by the public, these insurance and guarantee liabilities are fairly small. They were less than 2 percent of total liabilities in 2005.

Pension and Post-Employment Health Liabilities: The Federal Government owes pension benefits as a form of deferred compensation to retired workers and to current employees who will eventually retire. It also provides civilian retirees with subsidized health insurance through the Federal Employees Health Benefits program and military retirees receive similar benefits. Veterans are owed compensation for their service-related disabilities. While the Government's employee pension obligations have risen slowly, there has been a sharp increase in the liability for future health benefits and veterans compensation. The discounted present value of all these benefits was estimated to be around $4.4 trillion at the end of 2005 up from $3.0 trillion in 2000.[2] There was a large expansion in Federal military retiree health benefits legislated in 2001.

The Balance of Net Liabilities

The Government need not maintain a positive balance of net assets to assure its fiscal solvency, and the buildup in net liabilities since 1960 has not significantly affected Federal creditworthiness. Long-term Government interest rates in 2003 reached their lowest levels in 45 years, and in 2004–2005 they remained lower than at any time from 1965 through 2002. Despite the continued good performance of interest rates, there are limits to how much debt the Government can assume without putting its finances in jeopardy. Over an extended time horizon, the Federal Government must take in enough revenue to cover all of its spending including debt service. The Government's ability to service its debt in the long run cannot be gauged from a balance sheet alone. To judge the prospects for long-run solvency it is necessary to project the budget into the future. That is the subject of the next section.

[2] Estimates of these liabilities were derived from the 2005 Financial Report of the United States Government and Reports from earlier years. Values for some prior years were extrapolated. .

PART III—THE LONG-RUN BUDGET OUTLOOK

A balance sheet, with its focus on obligations arising from past transactions, can only show so much information. For the Government, it is also important to anticipate what future budgetary requirements might flow from current laws and policies. Despite the uncertainty surrounding the assumptions needed for such estimates, very long-run budget projections can be useful in sounding warnings about potential problems. Federal responsibilities extend well beyond the next five or ten years, and problems that may be small in that time frame can become much larger if allowed to grow.

Programs like Social Security and Medicare are expected to continue indefinitely, and so long-range projections for Social Security and Medicare have been prepared for decades. Budget projections for individual programs, even important ones such as Social Security and Medicare, however, cannot reveal the Government's overall budgetary position. Only by projecting the entire budget is it possible to anticipate whether sufficient resources will be available to meet all the anticipated requirements for individual programs. It is also necessary to estimate how the budget's future growth compares with that of the economy to judge how well the economy might be able to support future budgetary needs.

To assess the overall financial condition of the Government, it is necessary to examine the future prospects for all Government programs including the revenue sources that support Government spending. Such an assessment reveals that the key drivers of the long-range deficit are, not surprisingly, Social Security and Medicare along with Medicaid, the Federal program that helps States provide health coverage for low-income people and nursing home care for the elderly. Medicaid, like Medicare and Social Security, is projected to grow more rapidly than the economy over the next several decades and to add substantially to the overall budget deficit. Under current law, there is no offset anywhere in the budget large enough to cover all the demands that will eventually be imposed by Social Security, Medicare, and Medicaid.

Future budget outcomes depend on a host of unknowns—constantly changing economic conditions, unforeseen international developments, unexpected demographic shifts, the unpredictable forces of technological advance, and evolving political preferences to name a few. These uncertainties make even short-run budget forecasting quite difficult, and the uncertainties increase the further into the future projections are extended. While uncertainty makes forecast accuracy difficult to achieve, it enhances the importance of long-run budget projections because people are risk averse. It is not possible to assess the likelihood of future risks without projections. A full treatment of all the relevant risks is beyond the scope of this chapter, but the chapter does show how long-run budget projections respond to changes in some of the key economic and demographic parameters. Given the uncertainties, a useful first step is to work out the implications of expected developments on a "what if" basis.

The Impending Demographic Transition

In 2008, the first members of the huge generation born after World War II, the so-called baby boomers, will reach age 62 and become eligible for early retirement under Social Security. Three years later, they will turn 65 and become eligible for Medicare. In the years that follow, the elderly population will steadily increase, putting serious strains on the budget because of increased expenditures for Social Security and for the Government's health programs serving this population.

The pressures are expected to persist even after the baby boomers are gone. The Social Security actuaries project that the ratio of workers to Social Security beneficiaries will fall from around 3.3 currently to a little over 2 by the time most of the baby boomers have retired. From that point forward, because of lower fertility and improved mortality, the ratio is expected to continue to decline slowly. With fewer workers to pay the taxes needed to support the retired population, budgetary pressures will continue to grow. The problem posed by the demographic transition is a permanent one.

Currently, the three major entitlement programs—Social Security, Medicare and Medicaid—account for 43 percent of non-interest Federal spending, up from 30 percent in 1980. By 2035, when the remaining baby boomers will be in their 70s and 80s, these three programs could easily account for nearly two-thirds of non-interest Federal spending. At the end of the projection period, in 2080, the figure rises to around three-quarters of non-interest spending. In other words, under an extension of current-law formulas, almost all of the budget, aside from interest, would go to these three programs alone. To say the least, that would severely reduce the flexibility of the budget, and the Government's ability to respond to new challenges.

An Unsustainable Path

These long-run budget projections show clearly that the budget is on an unsustainable path, although the rise in the deficit unfolds gradually. The budget deficit is projected to decline as the economy expands over the next several years, while most of the baby boomers are still in the work force. As the baby boomers begin to reach retirement age in large numbers, the deficit begins to rise. In about 10 years, the deficit as a share of GDP is projected to reach a low point and then begin an inexorable increase. Without reforms, by the end of this chapter's projection period in 2080, rising deficits would have driven publicly held Federal debt to levels well above the previous peak level relative to GDP reached at the end of World War II. Long before that point is ever reached there is likely to be a crisis that will force budgetary changes, but the timing of the crisis and its resolution are impossible to predict.

The revenue projections start with the budget's estimate of receipts under the Administration's proposals. In the long run, receipts are assumed to increase as people's real incomes rise. The income tax is indexed for inflation, but not for real growth, so as real incomes rise, the effective income rate increases. This tendency is partly offset because many excise taxes are not indexed and therefore tend to decline in real terms as inflation pushes up the price level. Furthermore, payroll taxes are based on cash wages and the share of cash wages in total compensation and in overall GDP has been declining as workers receive a larger share of their compensation in the form of untaxed fringe benefits. These offsetting tendencies are not powerful enough, however, to prevent the overall tax share from rising somewhat in the long run. In the projections summarized in Table 13–2, the ratio of receipts to GDP rises to around 22 percent by the end of the 75-year period.[3]

In the past, these long-run budget projections have jumped off from the end point for the current budget. This year's Budget includes the effects of adding personal retirement accounts to Social Security. Personal accounts are one element within a set of larger reforms that would restore solvency to Social Security. The Administration has not yet specified a complete set of reforms to achieve solvency. Within the current budget horizon, these other reforms would not have significant budget effects. In the long range, however, their effects would be significant. Because these other reforms are not yet specified, the long-range projections shown here do not incorporate personal retirement accounts. Showing the personal account proposal in isolation would give a distorted picture of the budget effects of comprehensive Social Security reform.

The long-run budget outlook is highly uncertain (see the technical note at the end of this chapter for a further discussion of the forecasting assumptions used to make these budget projections). With pessimistic assumptions, the fiscal picture deteriorates even sooner than in the base projection. More optimistic assumptions imply a longer period before the pressures of rising entitlement spending overwhelm the budget. But despite the unavoidable uncertainty, these projections clearly show that under a wide range of forecasting assumptions, the resources generated by the programs themselves will be insufficient to cover the long-run costs of Social Security and Medicare.

Alternative Economic, Technical, and Policy Assumptions

The quantitative results discussed above are sensitive to changes in underlying economic and technical assumptions. Some of the most important of these alternative economic and technical assumptions and their effects on the budget outlook are discussed below. They generally show that there are mounting deficits under most reasonable projections of the budget.

1. *Health Spending:* The projections for Medicare over the next 75 years are based on the actuarial projections in the 2005 Medicare Trustees' Report that include the effects of the Medicare Prescription Drug and Modernization bill enacted in 2003.[4] Following the recommendations of its Technical Review Panel, the Medi-

[3] The Alternative Minimum Tax is also scheduled to take a growing share of income under current law, because its parameters are not indexed to inflation. That increase is not assumed to continue in these projections because it would imply a fundamental change in the tax system.

[4] The long-run projections do not incorporate the Administration's proposal for automatic spending reductions in Medicare if the program's future reliance on general revenues exceeds the threshold of 45 percent of expenditures established in the Medicare Modernization Act. This proposal is intended to encourage Congress and the President to reach agreement on reforms to slow Medicare spending to bring it back in line with the 45 percent threshold. Assuming that these automatic reductions would continue each year throughout the 75-year projection period would result in an unrealistic projection of Medicare spending.

Table 13–2. LONG-RUN BUDGET PROJECTIONS

(receipts, outlays, surplus or deficit, and debt as a percent of GDP)

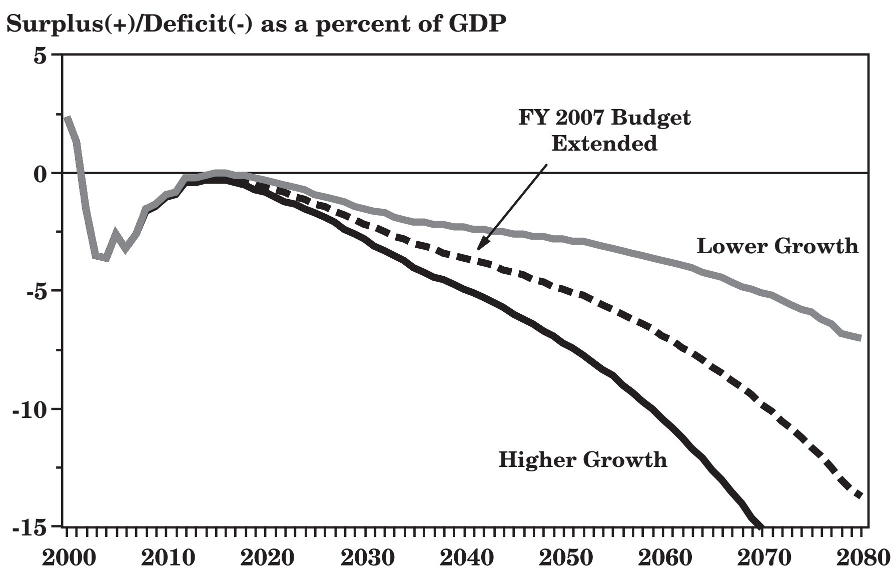
	1980	1990	2000	2010	2020	2030	2040	2060	2080
Receipts	19.0	18.0	20.9	17.9	18.9	19.4	20.0	21.3	22.4
Outlays:									
Discretionary	10.1	8.7	6.3	6.1	5.6	5.6	5.6	5.6	5.6
Mandatory:									
Social Security	4.3	4.3	4.2	4.2	4.9	5.8	5.9	6.1	6.4
Medicare	1.1	1.7	2.0	2.8	3.7	5.0	6.1	7.9	10.4
Medicaid	0.5	0.7	1.2	1.5	1.9	2.1	2.3	2.8	3.3
Other	3.7	3.2	2.4	2.3	1.9	1.6	1.4	1.1	0.9
Subtotal, mandatory	9.6	9.9	9.8	10.8	12.4	14.4	15.7	17.8	21.0
Net Interest	1.9	3.2	2.3	1.9	1.4	1.5	2.3	4.7	9.4
Total outlays	21.7	21.8	18.4	18.9	19.4	21.6	23.6	28.2	36.1
Surplus or Deficit (–)	–2.7	–3.9	2.4	–1.0	–0.6	–2.2	–3.6	–6.9	–13.7
Primary Surplus or Deficit (–)	–0.8	–0.6	4.7	0.9	0.9	–0.6	–1.3	–2.1	–4.2
Federal Debt Held by the Public	26.1	42.0	35.1	37.5	26.2	28.8	43.3	88.6	177.4

Note: The figures shown in this table for 2015 and beyond are the product of a long-range forecasting model maintained by the Office of Management and Budget. This model is separate from the models and capabilities that produce detailed programmatic estimates in the Budget. It was designed to produce long-range forecasts based on additional assumptions regarding growth of the economy, the long-range evolution of specific programs, and the demographic and economic forces affecting those programs. The model, its assumptions, and sensitivity testing of those assumptions are presented in this chapter.

care trustees assume that over the long-run "age-and gender-adjusted, per-beneficiary spending growth exceeds the growth of per-capita GDP by 1 percentage point per year." This implies that total Medicare spending will rise faster than GDP throughout the projection period.

Eventually, the rising trend in health care costs for both Government and the private sector will have to end, but it is hard to know when and how that will happen. Improved health and increased longevity are highly valued, and society has shown that it is willing to spend a larger share of income on them than it did in the past. Whether society will be willing to devote the large share of resources to health care implied by these projections is an open question. The alternatives highlight the effect of raising or lowering the projected growth rate in per capita health care costs by ¼ percentage point.

Chart 13-3. Health Care Cost Alternatives



2. *Discretionary Spending:* The projection of discretionary spending is essentially arbitrary, because discretionary spending is determined annually through the legislative process, and no formula can dictate future spending in the absence of legislation. Alternative assumptions have been made for discretionary spending in past budgets. Holding discretionary spending unchanged in real terms is the "current services" assumption used for baseline budget projections when there is no legislative guidance on future spending levels. Extending this assumption over many decades, however, is not realistic. When the population and economy grow, as assumed in these projections, the demand for public services is very likely to expand as well. The current base projection assumes that discretionary spending keeps pace with the growth in GDP in the long run, so that spending increases in real terms whenever there is real economic growth. An alternative assumption would be to limit the percentage increase in discretionary spending to the increase in population plus inflation, in other words, to hold the real per capita inflation-adjusted level of discretionary spending constant. This along with the projected rise in tax revenue produces a small budget surplus. Even in this case, the entitlement problem is not solved but the threat to the budget is postponed for several decades.

Chart 13-4. Alternative Discretionary Spending Assumptions

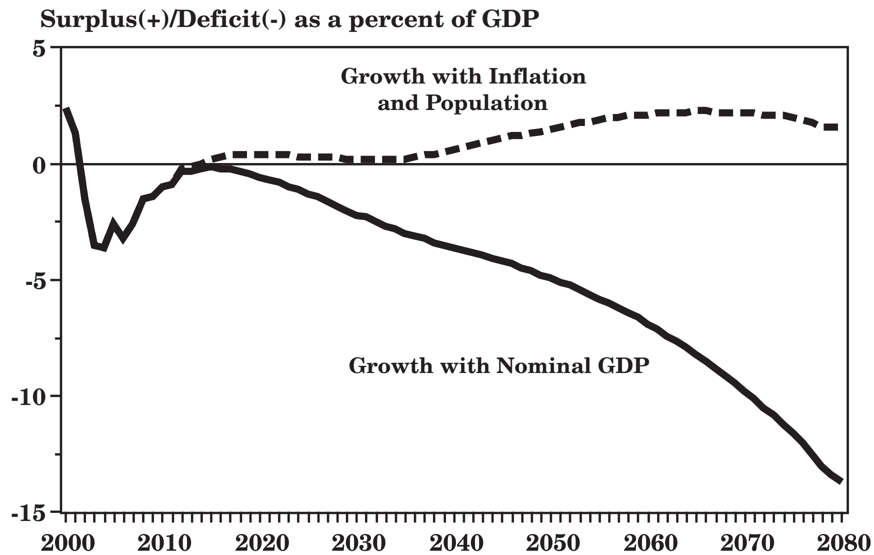
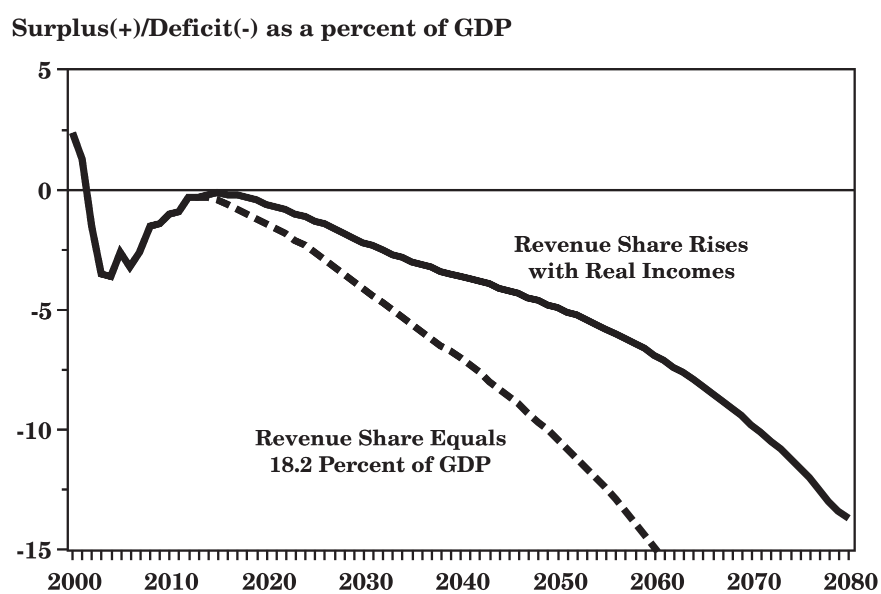


Chart 13-5. A Constant Revenue Share

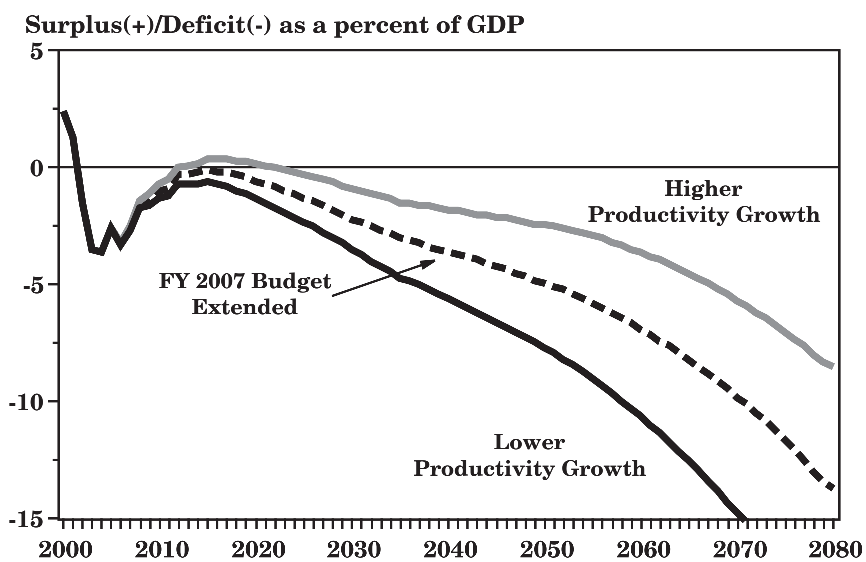


3. *A Constant Revenue Share:* In the base projection, individual income tax receipts gradually rise over time relative to GDP. This increase reflects the higher marginal tax rates that people face as their real incomes rise. Eventually, these higher rates would bring the ratio of receipts to GDP to unprecedented levels—22 percent after 75 years. Alternatively, receipts might be expected to hold within some long-run historical range.

Over the last 40 years, for example, receipts have averaged 18.2 percent of GDP. Tax receipts have risen above this ratio from time to time, most recently at the end of the 1990s, but those periods of high taxes have always been followed by tax changes that have restored the average tax ratio. Although such changes require legislation and so are not implied by current law, a plausible alternative is to hold the receipts ratio constant relative to GDP. In that case, the deficit rises somewhat faster than in the base assumptions.

4. *Productivity:* The rate of future productivity growth has a major effect on the long-run budget outlook. It is also highly uncertain. Over the next few decades an increase in productivity growth would reduce projected budget deficits appreciably. Higher productivity growth adds directly to the growth of the major tax bases, while it has only a delayed effect on outlay growth even assuming that in the long-run discretionary spending rises with GDP. In the latter half of the 1990s, after two decades of much slower growth, the rate of productivity growth increased unexpectedly and it has increased again since 2000. This increase in productivity growth is one of the most welcome developments of the last several years. Although the long-run growth rate of productivity is inherently uncertain, growth in real GDP per hour averaged 2.2 percent per year from 1948 through 1973 and again from 1995 through 2004. It has grown 2.6 percent per year since 2000, and the projections here assume that real GDP per hour will grow at a 2.3 percent annual rate. If the recent increase in trend productivity growth is sustained, it might continue growing faster than the historical average for some time to come. The alternatives highlight the effect of raising the projected productivity growth rate by ¼ percentage point and the effect of lowering it by the same amount.

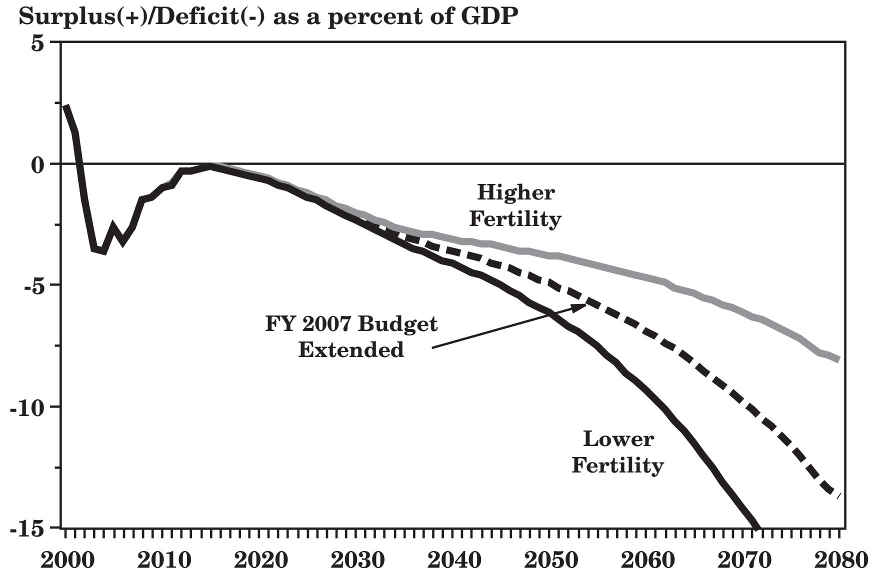
Chart 13-6. Alternative Productivity Assumptions



5. *Population:* The key assumptions for projecting long-run demographic developments are fertility, immigration, and mortality.

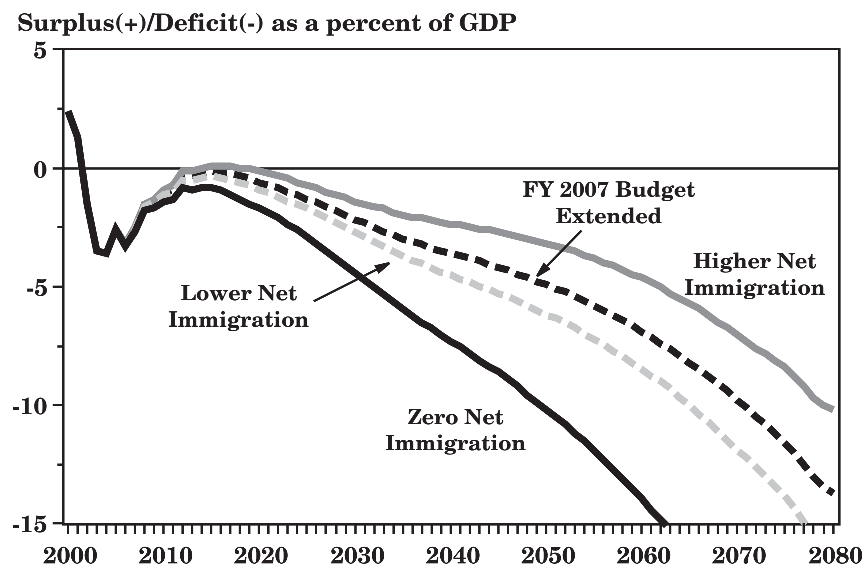
- The demographic projections assume that fertility will average around 1.9 births per woman in the future, just slightly below the replacement rate needed to maintain a constant population—2.1 births.

Chart 13-7. Alternative Fertility Assumptions



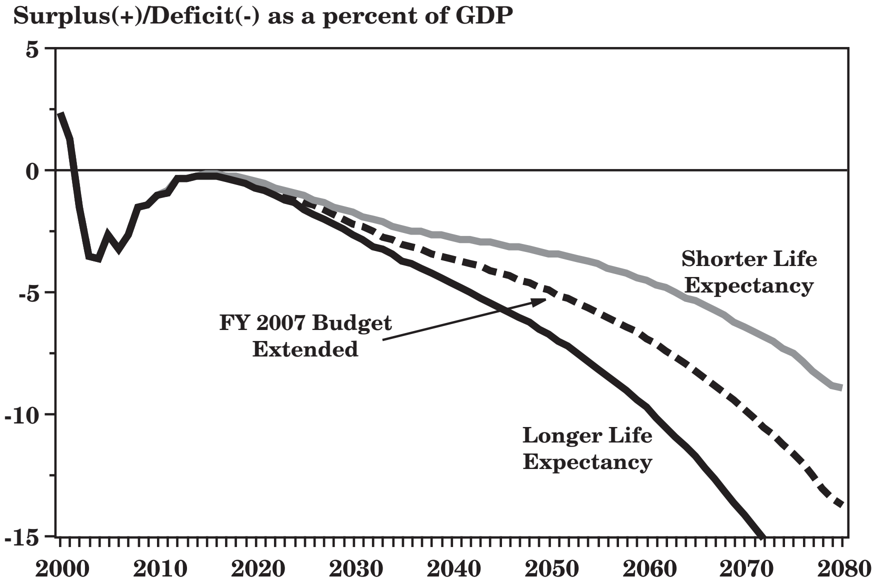
- The rate of immigration is assumed to average around 900,000 per year in these projections. Higher immigration relieves some of the downward pressure on population growth from low fertility and allows total population to expand throughout the projection period, although at a much slower rate than has prevailed historically.

Chart 13-8. Alternative Immigration Assumptions



- Mortality is projected to decline, i.e., people are expected to live longer. The average female lifespan is projected to rise from 79.6 years in 2004 to 85.2 years by 2080, and the average male lifespan is projected to increase from 74.6 years in 2004 to 81.7 years by 2080. A technical panel to the Social Security Trustees recently reported that the improvement in longevity might even be greater.

Chart 13-9. Alternative Mortality Assumptions



Actuarial Projections for Social Security and Medicare

Social Security and Medicare are the Government's two largest entitlement programs. Both rely on payroll tax receipts from current workers and employers for at least part of their financing, while the programs' benefits largely go to those who are retired. The importance of these programs for the retirement security of current and future generations makes it essential to understand their long-range financial prospects. Both programs' actuaries have calculated that they face persistent long-run deficits. How best to measure the long-run imbalance in Social Security is a challenging analytical question; the imbalance may be even more difficult to measure in Medicare, which includes both Hospital Insurance (HI), funded through the payroll tax, and Supplementary Medical Insurance (SMI), financed through premiums and general revenues. Under reasonable assumptions, however, each program embodies such a huge financial deficiency, and it will be very difficult for the Government as a whole to maintain control of the budget without addressing both of these programs' financial problems.

Social Security: The Long-Range Challenge

Social Security provides financial security for the elderly, the disabled, and survivors. The Social Security system is intended to be self-financing over time. The principle of self-financing is important because it compels corrections in the event that projected benefits consistently exceed dedicated receipts.

While Social Security is running surpluses today, it will begin running cash deficits within 12 years. Social Security's spending path is unsustainable under current law. The retirement of the baby-boom generation, born following World War II, will begin to increase greatly the number of Social Security beneficiaries within five years. Demographic trends toward lower fertility rates and longer life spans mean that the ratio of retirees to the working population will remain permanently higher following the baby boomers' passage through the system. The number of workers available to support each beneficiary is projected to decline from 3.3 today to 2.2 in 2030, and to continue to decline slowly from there. This decline in the workforce available to support retiree benefits means that the Government will not be able to meet current-law benefit obligations at current payroll tax rates.

The size of Social Security's future shortfall cannot be known with precision, but a gap between Social Security receipts and outlays emerges under a wide range of reasonable forecasting assumptions. Long-range uncertainty underscores the importance of creating a system that is financially stable and self-contained. Otherwise, the demands created by Social Security could compromise the rest of the budget and the Nation's economic health. The actuarial shortfall is estimated to be $12.8 trillion over an infinite horizon.

The current structure of Social Security leads to substantial generational differences in the average rate of return people can expect from the program. While previous generations have fared extremely well, the average individual born today can expect to receive less than a two percent annual real rate of return on their total payroll taxes (including the employer's portion, which most economists believe is ultimately borne by labor). Moreover, such estimates in a sense overstate the expected rate of return for future retirees, because they assume no changes in current-law taxes or benefits, even though such changes are needed to meet Social Security's financing shortfall. As an example, a 1995 analysis found that after adjusting revenues to keep the system solvent, a typical worker born in 2000 would receive a 1.5 percent rate of return instead of a 1.7 percent rate of return.

One way to address the issues of uncertainty and declining rates of return, while protecting national savings, would be to allow individuals to invest some of their payroll taxes in personal retirement accounts. The budget includes the estimated impact from the creation of personal accounts, funded through the Social Security payroll tax. The Administration has also embraced the concept of progressive indexing, which would significantly contribute to the solvency of the system by partially indexing the growth of benefits for higher-wage workers to inflation rather than wage growth.

Medicare: The Long-Range Challenge

Medicare provides health insurance for tens of millions of Americans, including most of the nation's seniors. It is composed of two programs: Hospital Insurance (HI) or Part A, which covers medical expenses relating to hospitalization, and Supplemental Medical Insurance (SMI) or Part B, which pays for physicians' services and other related expenditures. Starting this year, Medicare offers a voluntary prescription drug benefit, Medicare Part D, which is part of the SMI Trust Fund.

Like Social Security, HI is intended to be self-financing through dedicated taxes. According to the Medicare trustees' most recent report, the Trust Fund is projected to be depleted in 2020. Looking at the long run, the Medicare actuaries project a 75-year unfunded promise to Medicare's HI trust fund of around $8.6 trillion (net present value). However, this measure tells less than half the story because it does not include the deficiency in Medicare's Part B and Part D programs. The main source of dedicated revenues to the SMI Trust Fund is beneficiary premiums, which generally cover about one-quarter of its expenses. SMI's funding structure creates an enormous financing gap for the program, and is the largest contributor to the total Medicare program shortfall of $29.9 trillion. SMI's financing gap is covered by an unlimited tap on general revenues. According to the Medicare Trustees 2005 report, "When the Part D program becomes fully implemented in 2006, general revenue transfers are expected to constitute the largest single source of income to the Medicare program as a whole—and would add significantly to the Federal Budget pressures."

This bifurcated trust fund structure finances Medicare as if the program offers two separate, unrelated benefits, instead of recognizing that Medicare provides integrated, comprehensive health insurance coverage. The MMA took an important first step toward improving Medicare sustainability by requiring the Medicare Trustees' Report to include a new, comprehensive fiscal analysis of the program's financing and issue a warning if this analysis projects that the share of Medicare expenditures funded through general revenue funding exceeds 45 percent. However, while this warning requires the President to propose legislation to restore Medicare spending to sustainable levels, it does not mandate congressional action.

The Budget proposes to strengthen the MMA provision by modestly slowing the rate of Medicare growth if the MMA threshold is exceeded. The lower growth would be achieved through a four-tenths of a percent reduction to all payments beginning the year the threshold is exceeded. The change would only take effect if the President and Congress fail to agree on legislation to bring Medicare spending back into line with the threshold established by the MMA. The reduction would grow by four-tenths of a percent every year the shortfall continues to occur. This proposal would improve Medicare's sustainability by slowing the rate of growth in spending.

The Social Security and Medicare Trustees' Projections: In their annual reports and related documents, the Social Security and Medicare trustees typically present calculations of the 75-year actuarial imbalance or deficiency for Social Security and Medicare. The calculation covers current workers and retirees, as well as those projected to join the program within the next 75 years (this is the so-called "open-group"; the "closed-group" covers only current workers and retirees). These estimates measure the present value of each program's future benefits net of future income. They are complementary to the flow projections described in the preceding section. More recently, the trustees' reports have also included a projection of the deficiency in perpetuity. This is the clearest way to see the imbalances in both programs.

The present value of the Social Security imbalance over the next 75 years was estimated to be $5.7 trillion as of January 1, 2005. The comparable estimate for Medicare was $29.9 trillion. (The estimates in Table 13–3 were prepared by the Social Security and Medicare actuaries, and they are based on the intermediate economic and demographic assumptions used for the 2005 trustees' reports. These differ in some respects from the assumptions used for the long-run budget projections described in the preceding section, but Table 13–3 would still show large imbalances if the budget assumptions had been used for the calculations.) Doing the calculations for a 75-year horizon understates the deficiencies, because the 75-year actuarial calculations omit the large deficits that continue to occur beyond the 75th year. The understatement is significant, even though values in the distant future are discounted by a large amount. For example, merely adding an additional year to the estimating period would widen the imbalance for Social Security from $5.7 trillion to $5.8 trillion. Since 2004, the Social Security and Medicare actuaries have also presented the actuarial imbalances calculated in perpetuity without assuming a fixed horizon. Table 13–3 shows how much these distant benefits add to the programs' imbalances. For Social Security, the imbalance in perpetuity is $12.8 trillion and for Medicare it is a staggering $68.4 trillion as of January 1, 2005.

The imbalance estimated on a perpetuity basis is the amount that the Government would have to raise in the private capital markets to resolve the program's imbalance permanently (given current assumptions). If nothing else changes, the estimated imbalance will grow every year at approximately the rate of interest, just as an unpaid debt grows with interest each year it remains outstanding. For Social Security this implies an increase of approximately $600 billion in 2005 and growing amounts with every year that the imbalance remains unaddressed. The comparable imbalance in Medicare is much larger than the Social Security imbalance. The exact size of the imbalance is harder to estimate for Medicare because of greater uncertainty regarding the future growth of medical costs.

Social Security: The current deficiency in Social Security is essentially due to the fact that past and current participants will receive more benefits than they have paid for with taxes (calculated in terms of present values). By contrast, future participants—those who are now under age 15 or not yet born—are projected to pay in present value about $0.8 trillion more than they will collect in benefits. This can be seen by comparing the total deficiency in perpetuity, $12.8 trillion, with the excess of benefits over taxes for current program participants, $13.6 trillion, from Table 13–3. In other words, the taxes that future participants are expected to pay will be large enough to cover the benefits due them under current law, but not large enough to cover those benefits plus the benefits promised to current program participants in excess of the taxes paid by current program participants.

Medicare: Extending the horizon to infinity shows that the benefits due future participants will eventually exceed projected payroll tax receipts and premiums by a huge margin. The infinite horizon projections shown at the top of Table 13–3 reveal that total Medicare benefits exceed future taxes and premiums by $68.4 trillion in present value. This is due to an expected excess of benefits over taxes for current participants over their lifetimes, but also for future generations. Unlike Social Security, the imbalance is not simply the inherited result of a pay-as-you-go program that was never fully funded, and which faces a demographic crunch. That is part of the problem, but even more fundamental is the assumption that medical costs continue to rise in excess of general inflation so that medical spending increases in proportion to total output in the economy.

Passage of the Medicare Prescription Drug, Improvement and Modernization Act added substantially to Medicare's actuarial deficiency, as can be seen in the 75-year projections in Table 13–3 comparing 2003 with 2004. The legislation also increased private sector participation and added new fiscal safeguards which may help address Medicare's financial shortfall, but how large the impact of these changes will be is uncertain and their effects are not captured in the figures reported here.

Table 13–3. ACTUARIAL PRESENT VALUES OF BENEFITS IN EXCESS OF FUTURE TAXES AND PREMIUMS

In Perpetuity as of January 1, in Trillions of Dollars					2004	2005
Social Security	....	....	....	....	11.9	12.8
Medicare	....	....	....	....	61.9	68.4
Social Security and Medicare	....	....	....	....	73.8	81.2
Over a 75–Year Projection Period as of January 1, in Trillions of Dollars	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**
Social Security						
Future benefits less future taxes for those age 15 and over	9.6	10.5	11.2	11.7	12.6	13.6
Future benefits less taxes for those age 14 and under and those not yet born	–5.8	–6.3	–6.7	–6.8	–7.3	–7.9
Net present value for past, present and future participants	3.8	4.2	4.6	4.9	5.2	5.7
Medicare						
Future benefits less future taxes and premiums for those age 15 and over	9.9	12.5	12.9	15.0	24.6	26.3
Future benefits less taxes and premiums for those age 14 and under and those not yet born	–0.7	0.3	0.4	0.8	3.4	3.6
Net present value for past, present and future participants	9.2	12.8	13.3	15.8	28.1	29.9
Social Security and Medicare						
Future benefits less future taxes and premiums for those age 15 and over	....	23.0	24.1	26.7	37.2	39.9
Future benefits less taxes and premiums for those age 14 and under and not yet born	....	–6.0	–6.3	–6.0	–3.9	–4.3
Net present value for past, present and future participants	....	17.0	17.8	20.7	33.3	35.6
Addendum:						
Actuarial deficiency as a percent of the discounted payroll tax base:						
Social Security	–1.89	–1.86	–1.87	–1.92	–1.89	–1.92
Medicare HI	–1.21	–1.97	–2.02	–2.40	–3.12	–3.09

General revenues have covered about 75 percent of SMI program costs for many years, with the rest being covered by premiums paid by the beneficiaries. In Table 13–3, only the receipts explicitly earmarked for financing these programs have been included. The intragovernmental transfer is not financed by dedicated tax revenues, and the share of general revenues that would have to be devoted to SMI to close the gap increases substantially under current projections. Other Government programs also have a claim on these general revenues. From the standpoint of the Government as a whole, only receipts from the public can finance expenditures.

A significant portion of Medicare's actuarial deficiency is caused by the rapid expected increase in future benefits due to rising health care costs. Some, perhaps most, of the projected increase in relative health care costs reflects improvements in the quality of care, although there is also evidence that medical errors, waste, and excessive medical liability claims add needlessly to costs. But even though the projected increases in Medicare spending are likely to contribute to longer life-spans and safer treatments, the financial implications remain the same. As long as medical costs continue to outpace the growth of GDP and other expenditures, as assumed in these projections, the financial pressure on the budget will mount, and that is reflected in the estimates shown in Tables 13–2 and 13–3.

The Trust Funds and the Actuarial Deficiency: The fact that a special account or trust fund exists does not mean that the Government necessarily saved the money recorded there. The trust fund surpluses could have added to national saving if debt held by the public had actually been reduced because of the trust fund accumulations. But it is impossible to know for sure whether this happened or not.

At the time Social Security or Medicare redeems the debt instruments in the trust funds to pay benefits not covered by income, the Treasury will have to turn to the public capital markets to raise the funds to finance the benefits, just as if the trust funds had never existed. From the standpoint of overall Government finances, the trust funds do not reduce the future burden of financing Social Security or Medicare benefits, and for that reason, the trust funds are not netted against future benefits in Table 13–3. The eventual claim on the Treasury is better revealed by the difference between future benefits and future taxes or premiums.

In any case, trust fund assets remain small in size compared with the programs' future obligations and well short of what would be needed to pre-fund future benefits as indicated by the programs' actuarial deficiencies. Historically, Social Security and Medicare's HI program were financed mostly on a pay-as-you-go basis, whereby workers' payroll taxes were immediately used to pay retiree benefits. For the most part, workers' taxes have not been used to pre-fund their own future benefits, and taxes were not set at a level sufficient to pre-fund future benefits had they been saved.

The Importance of Long-Run Measures in Evaluating Policy Changes: Consider a proposed policy change in which payroll taxes paid by younger workers were reduced by $100 this year while the expected present value of these workers' future retirement benefits were also reduced by $100. The present value of future benefit payments would decrease by the same amount as the reduction in revenue. On a cash flow basis, however, the lost revenue occurs now, while the decrease in future outlays is in the distant future beyond the budget window, and the Federal Government must increase its borrowing to make up for the lost revenue in the meantime. If policymakers only focus on the Government's near-term borrowing needs, a reform such as this would appear to worsen the Government's finances, whereas the policy actually has a neutral impact.

Now suppose that future outlays were instead reduced by a little more than $100 in present value. In this case, the actuarial deficiency would actually decline, even though the Government's borrowing needs would again increase if the savings occurred outside the budget window. Focusing on the Government's near-term borrowing alone, therefore, can lead to a bias against policies that could improve the Federal Government's overall long-run fiscal condition. Taking a longer view of policy changes and considering measures of the Government's fiscal condition other than the unified budget surplus or deficit can correct for such mistakes.

PART IV—NATIONAL WEALTH AND WELFARE

Unlike a private corporation, the Federal Government routinely invests in ways that do not add directly to its assets. For example, Federal grants are frequently used to fund capital projects by State or local governments for highways and other purposes. Such investments are valuable to the public, which pays for them with its taxes, but they are not owned by the Federal Government and would not show up on a balance sheet for the Federal Government. It is true, of course, that by encouraging economic growth in the private sector, the Government augments future Federal tax receipts. However, the fraction of the return on investment that comes back to the Government in higher taxes is far less than what a private investor would require before undertaking a similar investment.

The Federal Government also invests in education and research and development (R&D). These outlays contribute to future productivity and are analogous to an investment in physical capital. Indeed, economists have computed stocks of human and knowledge capital to reflect the accumulation of such investments. Nonetheless, such hypothetical capital stocks are obviously not owned by the Federal Government, nor would they appear on a typical balance sheet as a Government asset, even though these investments also contribute to future tax receipts.

To show the importance of these kinds of issues, Table 13–4 presents a national balance sheet. It includes estimates of national wealth classified into three categories: physical assets, education capital, and R&D capital. The Federal Government has made contributions to each of these types of capital, and these contributions are shown separately in the table. At the same time, the private wealth shown in Table 13–4 generates future income and tax receipts, which finance future public activities. The Nation's wealth sets the ultimate limit on the resources available to the Government.

The table shows that Federal investments are responsible for about 7 percent of total national wealth including education and research and development. This may seem like a small fraction, but it represents a large volume of capital: $7.3 trillion. The Federal contribution is down from 8.9 percent in the mid-1980s and from 11.7 percent in 1960. Much of this reflects the relative decline in the stock of defense capital, which has fallen from around 34 percent of GDP in 1960 to under 6 percent in 2005.

Physical Assets: The physical assets in the table include stocks of plant and equipment, office buildings, residential structures, land, and the Government's physical assets such as military hardware and highways. Automobiles and consumer appliances are also included in this category. The total amount of such capital is vast, $55.5 trillion in 2005, consisting of $47.0 trillion in private physical capital and $8.5 trillion in public physical capital (including capital funded by State and local governments); by comparison, GDP was around $12 trillion in 2005. The Federal Government's contribution to this stock of capital includes its own physical assets of $3.1 trillion plus $1.3 trillion in accumulated grants to State and local governments for capital projects. The Federal Government has financed about one-quarter of all the physical capital held by other levels of government.

Education Capital: Economists have developed the concept of human capital to reflect the notion that individuals and society invest in people as well as in physical assets. Investment in education is a good example of how human capital is accumulated. Table 13–4 includes an estimate of the stock of capital represented by the Nation's investment in formal education and training. The estimate is based on the cost of replacing

Table 13–4. NATIONAL WEALTH

(As of the end of the fiscal year, in trillions of 2005 dollars)

	1960	1965	1970	1975	1980	1985	1990	1995	2000	2003	2004	2005
ASSETS												
Publicly Owned Physical Assets:												
Structures and Equipment	2.2	2.5	3.1	3.8	4.0	4.3	4.7	5.1	5.8	6.3	6.5	6.4
Federally Owned or Financed	1.3	1.3	1.5	1.6	1.7	2.0	2.1	2.2	2.2	2.3	2.4	2.4
Federally Owned	1.1	1.1	1.1	1.1	1.1	1.2	1.2	1.2	1.1	1.1	1.1	1.1
Grants to State and Local Governments	0.2	0.2	0.3	0.5	0.7	0.8	0.9	1.0	1.1	1.2	1.3	1.3
Funded by State and Local Governments	0.9	1.1	1.6	2.1	2.3	2.3	2.5	2.9	3.6	4.0	4.2	4.0
Other Federal Assets	0.8	0.7	0.7	0.9	1.4	1.5	1.2	0.9	1.3	1.5	1.7	2.0
Subtotal	2.9	3.2	3.8	4.7	5.4	5.7	5.8	6.0	7.1	7.8	8.2	8.5
Privately Owned Physical Assets:												
Reproducible Assets	7.5	8.6	10.6	13.5	17.6	18.6	21.1	23.4	28.4	31.0	32.6	33.6
Residential Structures	2.9	3.4	4.0	5.2	7.0	7.3	8.3	9.5	11.8	13.6	14.5	15.2
Nonresidential Plant & Equipment	3.0	3.4	4.3	5.6	7.2	7.9	8.8	9.6	11.6	12.2	12.7	12.9
Inventories	0.7	0.8	1.0	1.2	1.5	1.4	1.5	1.5	1.7	1.6	1.7	1.8
Consumer Durables	0.9	1.0	1.3	1.5	1.8	2.0	2.6	2.9	3.3	3.5	3.6	3.7
Land	2.2	2.6	3.0	3.9	6.0	6.9	7.1	5.4	8.2	9.8	11.2	13.4
Subtotal	9.7	11.3	13.6	17.4	23.6	25.4	28.2	28.8	36.7	40.8	43.8	47.0
Education Capital:												
Federally Financed	0.1	0.1	0.3	0.4	0.5	0.6	0.8	1.0	1.3	1.4	1.5	1.6
Financed from Other Sources	6.3	8.5	11.4	14.3	18.2	21.3	26.4	31.0	40.0	44.0	45.5	46.6
Subtotal	6.4	8.6	11.6	14.7	18.8	22.0	27.2	32.0	41.3	45.4	47.0	48.1
Research and Development Capital:												
Federally Financed R&D	0.2	0.4	0.5	0.6	0.6	0.7	0.9	1.0	1.1	1.2	1.2	1.2
R&D Financed from Other Sources	0.1	0.2	0.3	0.4	0.5	0.7	0.9	1.2	1.6	1.9	1.9	2.0
Subtotal	0.3	0.6	0.8	1.0	1.2	1.4	1.8	2.2	2.7	3.0	3.1	3.3
Total Assets	19.4	23.7	29.8	37.8	48.9	54.6	63.1	69.0	87.7	97.1	102.2	106.9
Net Claims of Foreigners on U.S. (+)	–0.1	–0.2	–0.2	–0.1	–0.4	0.1	0.8	1.6	3.1	4.1	4.3	5.5
Net Wealth	19.5	23.8	30.0	37.9	49.3	54.5	62.2	67.4	84.6	92.9	97.9	101.4
ADDENDA:												
Per Capita Wealth (thousands of 2005 $)	108.1	122.9	146.3	175.8	216.0	228.3	248.3	252.6	299.2	318.9	332.5	341.4
Ratio of Wealth to GDP (in percent)	691.4	673.1	707.2	789.8	857.7	794.9	776.0	744.5	764.6	793.6	805.0	805.0
Total Federally Funded Capital (trillions 2005 $)	2.3	2.6	3.0	3.5	4.3	4.8	5.0	5.1	5.8	6.4	6.8	7.3
Percent of National Wealth	11.7	10.7	9.9	9.3	8.7	8.9	8.0	7.6	6.9	6.9	6.9	7.2

the years of schooling embodied in the U.S. population aged 15 and over; in other words, the goal is to measure how much it would cost to reeducate the U.S. workforce at today's prices (rather than at the original cost). This is more meaningful economically than the historical cost of schooling, and is comparable to the methods used to estimate the physical capital stocks presented earlier.

Although this is a relatively crude measure, it does provide a rough order of magnitude for the current value of the investment in education. According to this measure, the stock of education capital amounted to $48.1 trillion in 2005, of which about 3 percent was financed by the Federal Government. It was approximately equal in value to the Nation's private stock of physical capital. The main investors in education capital have been State and local governments, parents, and students themselves.

Even broader concepts of human capital have been proposed. Not all useful training occurs in a schoolroom or in formal training programs at work. Much informal learning occurs within families or on the job, but measuring its value is very difficult. Labor compensation, however, amounts to about two-thirds of national income with the other third attributed to capital, and thinking of total labor income as the product of human capital suggests that the total value of human capital would be two times the estimated value of physical capital if human capital earned a similar rate of return to other forms of capital. Thus, the estimates offered here are in a sense conservative, because they reflect only the costs of acquiring formal education and training, which is why they are referred to as education capital rather than human capital. They constitute that part of total human capital that can be attributed to formal education and training.

Research and Development Capital: Research and Development can also be thought of as an investment, because R&D represents a current expenditure that is made in the expectation of earning a future return. After adjusting for depreciation, the flow of R&D investment can be added up to provide an estimate of the current R&D stock. [3] That stock is estimated to have been $3.3 trillion in 2005. Although this represents a large amount of research, it is a relatively small portion of total National wealth. Of this stock, 38 percent was funded by the Federal Government.

Liabilities: When considering how much the United States owes as a Nation, the debts that Americans owe to one another cancel out. When the debts of one American are the assets of another American, these debts are not a net liability of the Nation as a whole. Table 13–4 only shows National totals. Gross debt is important even though it does not appear in Table 13–4. The amount of debt owed by Americans to other Americans can exert both positive and negative effects on the economy. Americans' willingness and ability to borrow have helped fuel the current expansion by supporting consumption and housing purchases. On the other hand, growing debt could be a risk to future growth, if the ability to service the higher level of debt were to become impaired.

The only debts that show up in Table 13–4 are the debts Americans owe to foreigners for the investments that foreigners have made here. America's net foreign debt has been increasing rapidly in recent years, because of the rising imbalance in the U.S. current account. Although the current account deficit is at record levels, the size of the net foreign debt remains relatively small compared with the total stock of U.S. assets. It amounted to 5.5 percent of total assets in 2005.

Federal debt does not appear explicitly in Table 13–4 because most of it consists of claims held by Americans; only that portion of the Federal debt which is held by foreigners is included along with the other debts to foreigners. Comparing the Federal Government's net liabilities with total national wealth does, however, provide another indication of the relative magnitude of the imbalance in the Government's accounts. Federal net liabilities, as reported in Table 13–1, amounted to 5.6 percent of net U.S. wealth as shown in Table 13–4. Prospectively, however, Federal liabilities are a much larger share of national wealth, as indicated by the long-run projections described in Part III.

Trends in National Wealth

The net stock of wealth in the United States at the end of 2005 was $101 trillion, about eight times the size of GDP. Since 1960, it has increased in real terms at an average annual rate of 3.7 percent per year. It grew very rapidly from 1960 to 1973, at an average annual rate of 4.5 percent per year, slightly faster than real GDP grew over the same period. Between 1973 and 1995 growth slowed, as real net wealth grew at an average rate of just 3.1 percent per year, which paralleled the slowdown in real GDP over this period. Since 1995 the rate of growth in U.S. real wealth has picked up. Net wealth has been growing at an average rate of 4.2 percent since 1995, about the same rate as from 1960 to 1973. Productivity growth has also accelerated since 1995, following a similar slowdown from 1973 to 1995.

The net stock of privately owned nonresidential plant and equipment accounts for about 27 percent of all privately owned physical assets. In real terms, it grew 3.3 percent per year on average from 1960 to 2005. It grew especially rapidly from 1960 to 1973, at an average rate of 3.9 percent per year. Since 1973 it has grown more slowly, averaging around 3.0 percent per year. Plant and equipment did not experience a more rapid rate of growth over the last ten years compared with 1973–1995. Private plant and equipment grew 3.0 percent per year on average between 1973 and 1995 and at the same rate from 1995 through 2005. Privately owned residential structures and land have all grown much more rapidly in real value since

[3] R&D depreciates in the sense that the economic value of applied research and development tends to decline with the passage of time, as still newer ideas move the technological frontier.

1995 than from 1973 to 1995, while the stock of consumer durables has grown less rapidly.

The accumulation of education capital has averaged 4.6 percent per year since 1960. It also slowed down between 1973 and 1995 and has grown only slightly more rapidly since then. It grew at an average rate of 5.8 percent per year in the 1960s, 1.9 percentage points faster than the average rate of growth in private physical capital during the same period. Since 1995, education capital has grown at a 4.2 percent annual rate. This reflects both the extra resources devoted to schooling in this period, and the fact that such resources have been increasing in economic value. Meanwhile, R&D stocks have grown at an average rate of 4.0 percent per year since 1995.

Table 13–5. TRENDS IN NATIONAL WEALTH

(Average annual rates in percent)

	1960–2005	1960–1973	1973–1995	1995–2005
Real GDP	3.4	4.3	2.8	3.4
National Wealth	3.7	4.5	3.1	4.2
Private Physical Wealth	3.6	3.9	2.7	5.0
Nonresidential Plant and Equipment	3.3	3.9	3.0	3.0
Residential Structures	3.7	4.1	3.1	4.9
Public Physical Wealth	2.4	2.8	1.6	3.5
Net Education	4.6	5.8	4.1	4.2
Net R&D	5.3	8.6	3.9	4.0

Other Federal Influences on Economic Growth

Federal investment decisions, as reflected in Table 13–4, obviously are important, but the Federal Government also affects wealth in ways that cannot be easily captured in a formal presentation. The Federal Reserve's monetary policy affects the rate and direction of capital formation in the short run, and Federal regulatory and tax policies also affect how capital is invested, as do the Federal Government's policies on credit assistance and insurance.

Social Indicators

There are certain broad responsibilities that are unique to the Federal Government. Especially important are preserving national security, fostering healthy economic conditions including sound economic growth, promoting health and social welfare, and protecting the environment. Table 13–6 offers a rough cut of information that can be useful in assessing how well the Federal Government has been doing in promoting the domestic portion of these general objectives.

The indicators shown in Table 13–6 are only a subset drawn from the vast array of available data on conditions in the United States. In choosing indicators for this table, priority was given to measures that were consistently available over an extended period. Such indicators make it easier to draw valid comparisons and evaluate trends. In some cases, however, this meant choosing indicators with significant limitations.

TABLE 13–6. ECONOMIC AND SOCIAL INDICATORS

Calendar Years	1960	1970	1980	1990	1995	2000	2003	2004	2005
Economic:									
Living Standards:									
Real GDP per person (2000 dollars)	13,840	18,392	22,666	28,429	30,128	34,759	35,456	36,590	37,560
average annual percent change (5–year trend)	0.6	2.3	2.6	2.3	1.2	2.9	1.5	1.5	1.6
Median Income:									
All Households (2004 dollars)	N/A	36,795	38,453	41,963	41,943	46,058	44,482	44,389	N/A
Married Couple Families (2004 dollars)	31,742	44,302	50,245	55,910	57,927	64,825	63,955	63,630	N/A
Female Householder, Husband Absent (2004 dollars)	16,041	21,456	22,599	23,729	24,237	28,208	27,264	26,964	N/A
Income Share of Lower 60% of All Households	31.8	32.3	31.2	29.3	28.0	27.3	26.9	26.8	N/A
Poverty Rate (%) [1]	22.2	12.6	13.0	13.5	13.8	11.3	12.5	12.7	N/A
Economic Security:									
Civilian Unemployment (%)	5.5	4.9	7.1	5.5	5.6	4.0	6.0	5.5	5.1
CPI-U (% Change)	1.7	5.7	13.5	5.4	2.8	3.4	2.3	2.7	3.4
Payroll Employment Increase Previous 12 Months (millions)	–0.4	–0.4	0.3	0.3	2.2	1.9	0.1	2.2	2.0
Managerial or Professional Jobs (% of civilian employment)	N/A	N/A	N/A	29.2	32.0	33.8	34.8	34.9	34.7
Wealth Creation:									
Net National Saving Rate (% of GDP) [2]	10.6	8.3	7.4	4.4	4.1	5.9	1.3	1.2	0.5
Innovation:									
Patents Issued to U.S. Residents (thousands) [3]	42	51	42	56	68	104	106	101	N/A
Multifactor Productivity (average 5 year percent change)	0.8	0.8	0.8	0.6	0.7	1.1	N/A	N/A	N/A
Nonfarm Output per Hour (average 5 year percent change)	1.8	2.1	1.1	1.6	1.6	2.5	3.2	3.3	N/A
Environment:									
Air Quality:									
Nitrogen Oxide Emissions (thousands of tons)	18,163	26,883	27,079	25,529	24,956	22,598	20,728	N/A	N/A
Sulfur Dioxide Emissions (thousands of tons)	22,268	31,218	25,925	23,076	18,619	16,347	15,943	N/A	N/A
Carbon Monoxide (thousands of tons)	N/A	204,043	185,407	154,186	126,777	114,467	106,886	N/A	N/A
Lead Emissions (thousands of tons)	N/A	221	74	5	4	N/A	N/A	N/A	N/A
Water Quality:									
Population Served by Secondary Treatment or Better (mils)	N/A	85	N/A	162	174	179	N/A	N/A	N/A
Social:									
Families:									
Children Living with Mother Only (% of all children)	9.2	11.6	18.6	21.6	24.0	22.3	23.2	23.2	23.2
Safe Communities:									
Violent Crime Rate (per 100,000 population) [4]	160.0	364.0	597.0	729.6	684.5	506.5	475.8	465.5	463.2
Murder Rate (per 100,000 population) [4]	5.1	7.8	10.2	9.4	8.2	5.5	5.7	5.5	5.6
Murders (per 100,000 Persons Age 14 to 17)	N/A	N/A	5.9	9.8	11.0	4.8	N/A	N/A	N/A
Health:									
Infant Mortality (per 1000 Live Births) (e)	26.0	20.0	12.6	9.2	7.6	6.9	6.9	6.7	6.6
Low Birthweight [>2,500 gms] Babies (%) [5]	7.7	7.9	6.8	7.0	7.3	7.6	7.9	8.1	N/A
Life Expectancy at birth (years)	69.7	70.8	73.7	75.4	75.8	77.0	77.6	N/A	N/A
Cigarette Smokers (% population 18 and older) [6]	N/A	39.2	33.0	25.3	24.6	23.2	21.6	20.9	20.9
Overweight (% population 20–74 with Body-Mass Index >2.5)	44.5	47.5	47.4	55.3	59.3	64.7	N/A	N/A	N/A
Learning:									
High School Graduates (% of population 25 and older)	44.6	55.2	68.6	77.6	81.7	84.1	84.6	85.2	N/A
College Graduates (% of population 25 and older)	8.4	11.0	17.0	21.3	23.0	25.6	27.2	27.7	N/A
National Assessment of Educational Progress [7]									
Reading 17–year olds	N/A	N/A	285	290	288	287	286	285	N/A
Mathematics 17–year olds	N/A	N/A	299	305	307	308	307	307	N/A
Participation:									
Individual Charitable Giving per Capita (2000 dollars)	277	390	423	484	458	701	654	661	N/A
(by presidential election year)	(1960)	(1972)	(1980)	(1984)	(1988)	(1992)	(1996)	(2000)	(2004)
Voting for President (% eligible population)	63	55	53	53	50	55	49	50	56

[1] The poverty rate does not reflect noncash government transfers such as Medicaid or food stamps.
[2] 2005 through Q3 only.
[3] Preliminary data for 2004.
[4] Not all crimes are reported, and the fraction that go unreported may have varied over time, preliminary data for 2005.
[5] Data for 2004–2005 provisional, data for 2005 through June.
[6] Smoking data for 2005 through June.
[7] Data for some years are interpoated.

The individual measures in this table are influenced to varying degrees by many Government policies and programs, as well as by external factors beyond the Government's control. They do not measure the outcomes of Government policies, because they generally do not show the direct results of Government activities, but they do provide a quantitative measure of the progress or lack of progress toward some of the ultimate values that Government policy is intended to promote.

Such a table can serve two functions. First, it highlights areas where the Federal Government might need to modify its current practices or consider new approaches. Where there are clear signs of deteriorating conditions, corrective action might be appropriate. Second, the table provides a context for evaluating other data on Government activities. For example, Government actions that weaken its own financial position may be appropriate when they promote a broader social objective. The Government cannot avoid making such trade-offs because of its size and the broad ranging effects of its actions. Monitoring these effects and incorporating them in the Government's policy making is a major challenge.

It is worth noting that, in recent years, many of the trends in these indicators turned around. The improvement in economic conditions beginning around 1995 has been widely noted, and there have also been some significant social improvements. Perhaps, most notable has been the turnaround in the crime rate. Since reaching a peak in the early 1990s, violent crime has fallen by a third. The turnaround has been especially dramatic in the murder rate, which has been lower since 1998 than at any time since the 1960s. The 2001 recession had a negative effect on some of these indicators: unemployment rose and real GDP growth declined for a time. But as the economy recovered much of the improvement shown in Table 13–6 was preserved. Indeed, productivity growth, the best indicator of future changes in the standard of living accelerated. Since 2000, it has increased faster than in any other five-year period since the 1960s.

TECHNICAL NOTE: SOURCES OF DATA AND METHODS OF ESTIMATING

Long-Range Budget Projections

The long-range budget projections are based on demographic and economic assumptions. A simplified model of the Federal budget, developed at OMB, is used to compute the budgetary implications of these assumptions.

Demographic and Economic Assumptions: For the years 2006–2016, the assumptions are drawn from the Administration's economic projections used for the budget. These budget assumptions reflect the President's policy proposals. The economic assumptions are extended beyond this interval by holding constant inflation, interest rates, and unemployment at the levels assumed in the final year of the budget forecast. Population growth and labor force growth are extended using the intermediate assumptions from the 2005 Social Security trustees' report. The projected rate of growth for real GDP is built up from the labor force assumptions and an assumed rate of productivity growth. Productivity growth is held constant at the average rate of growth in the budget's economic assumptions.

- CPI inflation holds stable at 2.5 percent per year; the unemployment rate is constant at 5.0 percent; and the yield on 10-year Treasury notes is steady at 5.6 percent.
- Real GDP per hour, a measure of productivity, grows at the same average rate as in the Administration's medium-term projections—2.3 percent per year.
- Consistent with the demographic assumptions in the trustees' reports, U.S. population growth slows from around 1 percent per year to about half that rate by 2030, and slower rates of growth beyond that point. Annual population growth is only 0.2 percent at the end of the projection period in 2080.
- Real GDP growth declines over time because of the slowdown in population growth and the increase in the population over age 65, who supply less work effort than younger people do. Historically, real GDP has grown at an average yearly rate of 3.4 percent. In these projections, average real GDP growth eventually declines to around 2.5 percent per year.

The economic and demographic projections described above are set by assumption and do not automatically change in response to changes in the budget outlook. This is unrealistic, but it simplifies comparisons of alternative policies.

Budget Projections: For the period through 2011, receipts and outlays follow the budget's policy projections, except that the projections do not include Social Security personal accounts. In the long run, receipts are projected using simple rules of thumb linking income taxes, payroll taxes, excise taxes, and other receipts to projected tax bases derived from the economic projections. Discretionary spending grows at the rate of growth in nominal GDP. Social Security is projected by the Social Security actuaries using these long-range assumptions. Medicare benefits are projected based on the estimates in the 2005 Medicare trustees' report, adjusted for differences in the inflation rate and the growth rate in real GDP per capita. Federal pensions are derived from the most recent actuarial forecasts available at the time the budget is prepared, repriced using Administration inflation assumptions. Medicaid outlays are based on the economic and demographic projections in the model. Other entitlement programs are projected based on rules of thumb linking program spending to elements of the economic and demographic projections such as the poverty rate.

Federally Owned Assets and Liabilities

Financial Assets: The principal source of data is the Federal Reserve Board's Flow-of-Funds Accounts.

Fixed Reproducible Capital: Estimates were developed from the OMB historical data base for physical capital outlays and software purchases. The data base extends back to 1940 and was supplemented by data from other selected sources for 1915–1939. The source data are in current dollars. To estimate investment flows in constant dollars, it was necessary to deflate the nominal investment series. This was done using chained price indexes for Federal investment from the National Income and Product Accounts. The resulting capital stocks were aggregated into nine categories and depreciated using geometric rates roughly following those used by the Bureau of Economic Analysis in its estimates of physical capital stocks.

Fixed Nonreproducible Capital: Historical estimates for 1960–1985 were based on estimates in Michael J. Boskin, Marc S. Robinson, and Alan M. Huber, "Government Saving, Capital Formation and Wealth in the United States, 1947–1985," published in *The Measurement of Saving, Investment, and Wealth*, edited by Robert E. Lipsey and Helen Stone Tice (The University of Chicago Press, 1989). Estimates were updated using changes in the value of private land from the Flow-of-Funds Balance Sheets and from the Agriculture Department for farm land; the value of Federal oil deposits was extrapolated using the Producer Price Index for Crude Energy Materials.

Debt Held by the Public: Treasury data.

Insurance and Guarantee Liabilities: Sources of data are the OMB Pension Guarantee Model and OMB estimates based on program data. Historical data on liabilities for deposit insurance were also drawn from CBO's study, The Economic Effects of the Savings and Loan Crisis, issued January 1992.

Pension and Post-Employment Health Liabilities: The accrued liabilities for Federal retiree pensions and retiree health insurance along with the liability for Veterans disability compensation were derived from the *Financial Report of the United States Government* (and the Consolidated Financial Statement for some earlier years). Prior to 1976, the values were extrapolated.

Other Liabilities: The source of data for trade payables and miscellaneous liabilities is the Federal Reserve's Flow-of-Funds Accounts. The *Financial Report of the United States Government* was the source for benefits due and payable.

National Balance Sheet

Publicly Owned Physical Assets: Basic sources of data for the federally owned or financed stocks of capital are the Federal investment flows described in Chapter 6. Federal grants for State and local government capital are added, together with adjustments for inflation and depreciation in the same way as described above for direct Federal investment. Data for total State and local government capital come from the revised capital stock data prepared by the Bureau of Economic Analysis extrapolated for 2005.

Privately Owned Physical Assets: Data are from the Flow-of-Funds national balance sheets and from the private net capital stock estimates prepared by the Bureau of Economic Analysis extrapolated for 2005 using investment data from the National Income and Product Accounts.

Education Capital: The stock of education capital is computed by valuing the cost of replacing the total years of education embodied in the U.S. population 15 years of age and older at the current cost of providing schooling. The estimated cost includes both direct expenditures in the private and public sectors and an estimate of students' forgone earnings, i.e., it reflects the opportunity cost of education. Estimates of students' forgone earnings are based on the minimum wage for high-school students and year-round, full-time earnings of 18–24 year olds for college students. These year-round earnings are reduced by 25 percent because students are usually out of school three months of the year. Yearly earnings by age and educational attainment are from the Bureau of the Census.

For this presentation, Federal investment in education capital is a portion of the Federal outlays included in the conduct of education and training. This portion includes direct Federal outlays and grants for elementary, secondary, and vocational education and for higher education. The data exclude Federal outlays for physical capital at educational institutions because these outlays are classified elsewhere as investment in physical capital. The data also exclude outlays under the GI Bill; outlays for graduate and post-graduate education spending in HHS, Defense and Agriculture; and most outlays for vocational training. The Federal share of the total education stock in each year is estimated by averaging the prior years' shares of Federal education outlays in total education costs.

Data on investment in education financed from other sources come from educational institution reports on the sources of their funds, published in U.S. Department of Education, Digest of Education Statistics. Nominal expenditures were deflated by the implicit price deflator for GDP to convert them to constant dollar values. Education capital is assumed not to depreciate, but to be retired when a person dies. An education capital stock computed using this method with different source data can be found in Walter McMahon, "Relative Returns to Human and Physical Capital in the U.S. and Efficient Investment Strategies," *Economics of Education Review*, Vol. 10, No. 4, 1991. The method is described in detail in Walter McMahon, *Investment in Higher Education, Lexington Books*, 1974.

Research and Development Capital: The stock of R&D capital financed by the Federal Government was developed from a data base that measures the conduct of R&D. The data exclude Federal outlays for physical capital used in R&D because such outlays are classified elsewhere as investment in federally financed physical capital. Nominal outlays were deflated using the GDP deflator to convert them to constant dollar values.

Federally funded capital stock estimates were prepared using the perpetual inventory method in which annual investment flows are cumulated to arrive at a capital stock. This stock was adjusted for depreciation by assuming an annual rate of depreciation of 10 percent on the estimated stock of applied research and development. Basic research is assumed not to depreciate. These are the same assumptions used in a study published by the Bureau of Labor Statistics estimating the R&D stocks financed by private industry (U.S. Department of Labor, Bureau of Labor Statistics, "The Impact of Research and Development on Productivity Growth," Bulletin 2331, September 1989). Chapter 6 of this volume contains additional details on the estimates of the total federally financed R&D stock, as well as its national defense and nondefense components.

A similar method was used to estimate the stock of R&D capital financed from sources other than the Federal Government. The component financed by universities, colleges, and other nonprofit organizations is estimated based on data from the National Science Foundation, Surveys of Science Resources. The industry-financed R&D stock component is estimated from that source and from the U.S. Department of Labor, "The Impact of Research and Development on Productivity Growth," Bulletin 2331, September 1989.

Experimental estimates of R&D capital stocks have been prepared by BEA. The results are described in "A Satellite Account for Research and Development," *Survey of Current Business*, November 1994. These BEA estimates are lower than those presented here primarily because BEA assumes that the stock of basic research depreciates, while the estimates in Table 13–4 assume that basic research does not depreciate. BEA also assumed a slightly higher rate of depreciation for applied research and development, 11 percent, compared with the 10 percent rate used here.

Sources of Data and Assumptions for Estimating Social Indicators

The main sources for the data in this table are the Government statistical agencies. The data are all publicly available, and can be found in such general sources as the annual *Economic Report of the President* and the *Statistical Abstract of the United States*, or from the respective agencies' web sites.

14. NATIONAL INCOME AND PRODUCT ACCOUNTS

The National Income and Product Accounts (NIPAs) are an integrated set of measures of aggregate U.S. economic activity that are prepared by the Department of Commerce. Because the NIPAs include Federal transactions and are widely used in economic analysis, it is important to show the NIPAs' distinctive presentation of Federal transactions and contrast it with that of the budget.

One of the main purposes of the NIPAs is to measure the Nation's total production of goods and services, known as gross domestic product (GDP), and the incomes generated in its production. GDP is a measure of the Nation's final output, which excludes intermediate product to avoid double counting. Both government consumption expenditures and government gross investment—State and local as well as Federal—are included in GDP as part of final output, together with personal consumption expenditures, gross private domestic investment, and net exports of goods and services (exports minus imports).

Other government expenditures—social benefits, grants to State and local governments, subsidies, and interest payments—are not purchases of final output and as such are not included in GDP; however, these transactions are recorded in the NIPA government current receipts and expenditures account, together with government consumption expenditures (which includes depreciation on government gross investment).

Federal transactions are included in the NIPAs as part of the government sector.[1] The Federal subsector is designed to measure certain important economic effects of Federal transactions in a way that is consistent with the conceptual framework of the entire set of integrated accounts. The NIPA Federal subsector is not itself a budget, because it is not a financial plan for proposing, determining, and controlling the fiscal activities of the Government. Also, it features current transactions, whereas the budget includes transactions that the NIPA current account omits from its current receipts and current expenditure totals as "capital transfers." NIPA concepts also differ in many other ways from budget concepts, and therefore the NIPA presentation of Federal finances is significantly different from that of the budget.

Differences Between the NIPAs and the Budget

Federal transactions in the NIPAs are measured according to NIPA accounting concepts in order to be compatible with the purposes of the NIPAs and other transactions recorded in the NIPAs. As a result they differ from the budget in netting and grossing, timing, and coverage. These differences cause current receipts and expenditures in the NIPAs to differ from total receipts and outlays in the budget, albeit by relatively small amounts.[2] Differences in timing and coverage also cause the NIPA net Federal Government saving to differ from the budget surplus or deficit. Netting and grossing differences have equal effects on receipts and expenditures and thus have no effect on net Government saving. Besides these differences, the NIPAs combine transactions into different categories from those used in the budget.

Netting and grossing differences arise when the budget records certain transactions as offsets to outlays while they are recorded as current receipts in the NIPAs (or vice versa). The budget treats all income that comes to the Government due to its sovereign powers—mainly, but not exclusively, taxes—as governmental receipts. The budget offsets against outlays any income that arises from voluntary business-type transactions with the public. The NIPAs often follow this concept as well, and income to Government revolving accounts (such as the Government Printing Office) is offset against their expenditures. However, the NIPAs have a narrower definition of "business-type transactions" than does the budget. Two classes of receipts, rents and royalties, and some regulatory or inspection fees, both of which are classified as offsets to outlays in the budget, are recorded in the NIPAs as Government receipts (income receipts on assets and current transfer receipts, respectively). The NIPAs include Medicare premiums as Government receipts, while the budget classifies them as business-type transactions (offsetting receipts). In addition, the NIPAs treat the net surplus of Government enterprises as a component of current receipts.

In the budget, any intragovernmental income paid from one account to another is offset against outlays rather than being recorded as a receipt so that total outlays and receipts measure transactions with the public. Government contributions for Federal employee social insurance (such as Social Security) is an example: the budget offsets these payments against outlays. In contrast, the NIPAs treat the Federal Government like any other employer and show contributions for Federal employee social insurance as expenditures by the employing agencies and as governmental (rather than offsetting) receipts. The NIPAs also impute certain transactions that are not explicit in the budget. For example, unemployment benefits for Federal employees are financed by direct appropriations rather than social insurance contributions. The NIPAs impute social insurance contributions by employing agencies to finance

[1] The other subsector of the NIPA government sector is a single set of transactions for all U.S. State and local units of government, treated as a consolidated entity.

[2] Over the period 1994–2005, NIPA current expenditures averaged 4.5 percent higher than budget outlays, while NIPA current receipts averaged 3.5 percent higher than budget receipts.

these benefits—again, treating the Federal Government like any other employer.

Timing differences for receipts occur because the NIPAs generally record personal taxes and social insurance contributions when they are paid and business taxes when they accrue, while the budget generally records all receipts when they are received. Thus the NIPAs attribute corporations' final settlement payments back to the quarter(s) in which the profits that gave rise to the tax liability occurred. The delay between accrual of liability and Treasury receipt of payment can result in significant timing differences between NIPA and budget measures of receipts for any given accounting period.

Timing differences also occur for expenditures. When the first day of a month falls on a weekend or holiday, monthly benefit checks normally mailed on the first day of the month may be mailed out a day or two earlier; the budget then reflects two payments in one month and none the next. As a result, the budget totals occasionally reflect 13 monthly payments in one year and only 11 the next. NIPA expenditure figures always reflect 12 benefit payments per year, giving rise to a timing difference compared to the budget.

Coverage differences also differentiate the budget and the NIPAs. Certain items in the budget are excluded from the NIPA Federal current account because they are capital transfers unrelated to current economic production. Examples include Federal investment grants to State and local governments, investment subsidies to business, lump sum payments to amortize the unfunded liability of the Uniformed Services Retiree Health Care Fund, and forgiveness of debt owed by foreign governments. Likewise, estate and gift taxes, included in budget receipts, are excluded from NIPA current receipts as being capital transfers. They also exclude the proceeds from the sales of nonproduced assets such as land. Bonuses paid on Outer Continental Shelf oil leases and proceeds from broadcast spectrum auctions are shown as offsetting receipts in the budget and are deducted from budget outlays. In the NIPAs these transactions are excluded from the Federal current account as an exchange of assets with no current production involved. Also unlike the budget, the NIPAs exclude transactions with U.S. territories.

A coverage difference arises on the expenditure side because of the NIPA treatment of Government investment. The budget includes outlays for Federal investments as they are paid, while the NIPA Federal current account instead excludes current investments but includes a depreciation charge on past investments ("consumption of general government fixed capital") as part of "current expenditures." The inclusion of depreciation on fixed capital (structures, equipment and software) in current expenditures is a proxy for the services that capital renders; i.e., for its contribution to Government output of public services.

The treatment of Government pension plan income and outgo creates a coverage difference. Whereas the budget treats employee payments to these pension plans as governmental receipts, and employer contributions by agencies as offsets to outlays because they are intragovernmental, the NIPAs treat both of these components of employee compensation as personal income, in the same way as it treats contributions to pension plans in the private (household) sector. Likewise, the budget records a Government check to a retired Government employee as an outlay, but under NIPA concepts, no Government expenditure occurs at that time; the payment is treated (like private pension payments) as a transfer of income within the household sector.

Financial transactions such as loan disbursements, loan repayments, loan asset sales, and loan guarantees are excluded from the NIPAs on the grounds that such transactions simply involve an exchange of assets rather than current production, income, or consumption. In contrast, under the Federal Credit Reform Act of 1990, the budget records the estimated subsidy cost of the direct loan or loan guarantee as an outlay when the loan is disbursed. The cash flows with the public are recorded in nonbudgetary accounts as a means of financing the budget rather than as budgetary transactions themselves. This treatment recognizes that part of a Federal direct loan is an exchange of assets with equal value but part is a subsidy to the borrower. It also recognizes the subsidy normally granted by loan guarantees. In the NIPAs, neither the subsidies nor the loan transactions are included. However, the NIPAs, like the budget, include all interest transactions with the public, including interest received by and paid to the loan financing accounts; and both the NIPAs and the budget include administrative costs of credit program operations.

Deposit insurance outlays for resolving failed banks and thrift institutions are similarly excluded from the NIPAs on the grounds that there are no offsetting current income flows from these transactions. In 1991, this exclusion was the largest difference between the NIPAs and the budget and made NIPA net Government saving a significantly smaller negative number than the budget deficit that year. In subsequent years, as assets acquired from failed financial institutions were sold, these collections tended to make the budget deficit a smaller negative figure than NIPA net Federal Government saving.

Table 14–1. FEDERAL TRANSACTIONS IN THE NATIONAL INCOME AND PRODUCT ACCOUNTS, 1996–2007

(in billions of dollars)

Description	Actual										Estimate	
	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
CURRENT RECEIPTS												
Current tax receipts	913.6	1,010.2	1,105.9	1,165.2	1,305.6	1,266.9	1,089.7	1,054.2	1,084.8	1,325.6	1,420.0	1,516.1
Personal current taxes	648.2	729.0	814.1	868.5	987.4	993.8	851.1	779.0	774.4	920.0	994.5	1,098.4
Taxes on production and imports	73.0	77.2	80.7	82.5	87.8	86.4	86.4	89.1	92.8	102.3	106.1	111.0
Taxes on corporate income	187.7	198.9	205.9	207.9	223.5	179.5	144.7	178.0	208.9	293.5	309.4	296.6
Taxes from the rest of the world	4.7	5.1	5.2	6.2	6.8	7.1	7.4	8.1	8.7	9.9	10.0	10.0
Contributions for government social insurance	535.3	565.4	604.4	642.2	687.8	713.8	729.6	752.5	800.3	838.9	893.8	948.8
Income receipts on assets	26.6	26.7	22.3	20.9	24.3	26.4	21.3	21.4	22.0	22.3	25.9	26.5
Current transfer receipts	19.1	23.8	21.0	21.8	24.9	26.5	25.5	24.9	27.6	8.3	35.1	35.8
Current surplus of government enterprises	–1.9	0.2	–*	0.3	–1.3	–6.5	–1.1	2.1	0.2	–4.8	–4.9	–6.6
Total current receipts	1,492.7	1,626.4	1,753.5	1,850.3	2,041.2	2,027.1	1,865.0	1,855.1	1,934.9	2,190.4	2,369.9	2,520.6
CURRENT EXPENDITURES												
Consumption expenditures	436.8	454.6	452.9	469.5	496.0	519.7	575.5	646.6	707.5	772.6	831.1	837.0
Defense	295.5	304.4	301.3	307.2	321.2	335.7	368.4	424.2	471.2	511.4	549.6	549.9
Nondefense	141.3	150.2	151.6	162.3	174.8	184.0	207.1	222.5	236.3	261.1	281.5	287.1
Current transfer payments	873.0	908.2	940.3	976.4	1,023.2	1,108.0	1,216.6	1,308.2	1,378.4	1,461.8	1,580.7	1,678.3
Government social benefits	670.2	700.0	716.4	733.0	762.7	823.6	900.9	955.1	1,006.4	1,072.7	1,176.1	1,274.2
Grants-in-aid to State and local governments	188.6	194.1	209.9	227.7	244.1	268.2	296.7	329.9	347.5	360.9	371.8	377.8
Other transfers to the rest of the world	14.1	14.2	14.0	15.7	16.4	16.3	19.0	23.2	24.5	28.3	32.9	26.4
Interest payments	295.8	299.4	299.7	285.9	283.3	267.9	234.9	215.9	219.3	247.0	284.2	316.4
Subsidies	33.3	31.3	33.6	36.1	49.6	53.7	37.9	45.2	43.2	44.9	55.1	59.2
Wage disbursements less accruals	....	....	....	....	....	....	....	....	....	....	....	....
Total current expenditures	1,638.9	1,693.5	1,726.5	1,767.9	1,852.0	1,949.3	2,064.9	2,216.0	2,348.5	2,526.2	2,751.2	2,891.0
Net Federal Government saving	–146.1	–67.1	27.0	82.4	189.2	77.8	–199.9	–361.0	–413.6	–335.8	–381.3	–370.4
ADDENDUM: TOTAL RECEIPTS AND EXPENDITURES												
Current receipts	1,492.7	1,626.4	1,753.5	1,850.3	2,041.2	2,027.1	1,865.0	1,855.1	1,934.9	2,190.4	2,369.9	2,520.6
Capital transfer receipts	17.1	19.7	23.9	27.6	28.8	28.2	26.4	21.7	24.7	24.6	27.4	23.5
Total receipts	1,509.8	1,646.1	1,777.4	1,877.9	2,070.0	2,055.3	1,891.3	1,876.8	1,959.6	2,215.0	2,397.3	2,544.1
Current expenditures	1,638.9	1,693.5	1,726.5	1,767.8	1,852.0	1,949.3	2,064.9	2,216.0	2,348.5	2,526.2	2,751.2	2,891.0
Net investment:												
Gross government investment:												
Defense	52.6	44.5	45.4	46.5	48.5	49.9	54.5	58.8	66.0	70.4	74.6	75.1
Nondefense	28.5	28.5	29.7	31.9	32.2	30.3	32.6	33.1	32.7	33.8	37.1	38.2
Less: Consumption of fixed capital:												
Defense	61.4	60.6	59.8	59.7	60.2	60.3	60.4	61.4	63.4	67.2	70.0	72.8
Nondefense	20.6	21.8	22.9	24.5	26.5	27.7	28.2	28.6	29.1	29.8	32.5	36.1
Capital transfer payments	27.7	28.9	28.2	31.3	35.1	39.8	44.3	61.8	62.4	63.2	69.8	75.4
Net purchases of nonproduced assets	–0.1	–11.0	–5.3	–1.7	–0.3	–0.9	0.2	0.0	0.1	0.1	0.2	–19.5
Total expenditures	1,665.5	1,702.2	1,741.8	1,791.7	1,880.8	1,980.3	2,108.0	2,279.8	2,417.2	2,708.2	2,951.3	3,069.0
Net lending or net borrowing (–)	–155.7	–56.0	35.7	86.1	189.2	74.9	–216.7	–403.0	–457.6	–493.2	–554.1	–524.8

* $50 million or less.

Federal Sector Current Receipts

Table 14–1 shows Federal current receipts in the five major categories and four of the subcategories used in the NIPAs, which are similar to the budget categories but with significant differences.

Current tax receipts is the largest category of current receipts, and its personal current taxes subcategory—composed primarily of the individual income tax—is the largest single subcategory. The NIPAs' taxes on corporate income subcategory differs in classification from the corresponding budget category primarily because the NIPAs include the deposit of earnings of the Federal Reserve System as corporate income taxes, while the budget treats these collections as miscellaneous receipts. (The timing difference between the NIPAs and the budget is especially large for corporate receipts.) The taxes on production and imports subcategory is composed of excise taxes and customs duties.

Contributions for Government social insurance is the second largest category of current receipts. It differs from the corresponding budget category primarily because: (1) the NIPAs include Federal employer contributions for social insurance as a governmental receipt, while the budget offsets these contributions against outlays as undistributed offsetting receipts; (2) the NIPAs include premiums for Parts B and D of Medicare as governmental receipts, while the budget nets them against outlays; (3) the NIPAs treat Government employee contributions to their pension plans as a transfer of personal income within the household sector (as if the pension system were private), while the budget includes them in governmental receipts; and (4) the NIPAs impute employer contributions for Federal employees' unemployment insurance and workers' compensation.

The income receipts on assets category consists mainly of interest payments received on Government direct loans (such as student loans) and rents and royalties on Outer Continental Shelf oil leases. The current transfer receipts category consists primarily of deposit insurance premiums, fees, fines and other receipts from both individuals and businesses, less insurance settlements from the National Flood Insurance Program—virtually all of which are netted against outlays in the budget. The current surplus (or deficit) of Government enterprises category was formerly netted against subsidies on the expenditure side of the accounts. This is the profit or loss of "Government enterprises," such as the Postal Service, which are business-type operations of Government that usually appear in the budget as public enterprise revolving funds. Depreciation (consumption of enterprise fixed capital) is netted in calculating the current surplus of Government enterprises.

Federal Sector Current Expenditures

Table 14–1 shows current expenditures in five major NIPA categories and five subcategories, which are also very different from the budget categories.

Government consumption expenditures are the goods and services purchased by the Federal Government in the current account, including compensation of employees and depreciation. Gross investment (shown among the addendum items in Table 14–1) is thus excluded from current expenditures in computing net Government saving on a NIPA basis, whereas depreciation—charges on federally owned fixed capital—("consumption of general government fixed capital") is included. The NIPAs treat State and local investment and capital consumption in the same way—regardless of the extent to which it is financed with Federal aid (capital transfer payments) or from State and local own-source receipts.

Although gross investment is not included in Government current expenditures, both Government gross investment and current consumption expenditures (including depreciation) are included in total GDP, which makes the treatment of the government sector in the NIPAs similar to that of the private sector. Investment includes structures, equipment, and computer software.

Current transfer payments is the largest expenditure category. Transfer payments for Government social benefits consist mainly of income security and health programs, such as Social Security and Medicare paid to U.S. residents—and to retirees living outside the United States-Payment of pension benefits to former Government employees is not included, as explained previously. Grants-in-aid to State and local governments help finance a range of programs, including income security, Medicaid, and education (but capital transfer payments for construction of highways, airports, waste-water treatment plants, and mass transit are excluded). "Current transfer payments to the rest of the world (net)" consists mainly of grants to foreign governments.

Interest payments is the interest paid by the Government on its debt (excluding debt held by trust funds, other than Federal employee pension plans; and other Government accounts). Where the budget nets interest received on loans against outlays, the NIPAs now treat it as current receipts.

Subsidies consist of subsidy payments for resident businesses (excluding subsidies for investment). NIPA subsidies do not include the imputed credit subsidies estimated as budget outlays under credit reform. Rather, as explained previously loans and guarantees are categorized as financial transactions and are excluded from the NIPAs except for associated interest and fees.

Wage disbursements less accruals is an adjustment that is necessary to the extent that the wages paid in a period differ from the amount earned in the period.

Differences in the Estimates

Since the introduction of the unified budget in January 1968, NIPA current receipts have been greater than budget receipts in most years. This is due principally to grossing differences and the fact that estate and gift taxes, which the NIPAs exclude as capital transfers, roughly matched Medicare premiums, which the NIPAs include as a governmental receipt but the budget treats as an offsetting receipt. (In the budget, offsetting receipts are netted against the outlay total and not included in the governmental receipts total.) Since 1986, NIPA current expenditures have usually been higher than budget outlays (from which the Medicare premiums and employer retirement contributions are netted out as offsetting receipts), despite the omission from NIPA expenditures of capital transfer grants and pension benefit payments to former Government employees.

Two components of budget outlays, however, are sometimes sufficiently large in combination to exceed the netting and grossing adjustments. These are financial transactions and net investment (the difference between gross investment and depreciation). Large outlays associated with resolving the failed savings and loan associations and banks in 1990 and 1991 caused those year's budget outlays to exceed NIPA current expenditures. With the change in budgetary treatment of direct loans in 1992 under credit reform, one type

Table 14–2. RELATIONSHIP OF THE BUDGET TO THE FEDERAL SECTOR, NIPA's

Description	Actual									Estimate		
	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
RECEIPTS												
Budget receipts	1,453.2	1,579.4	1,722.0	1,827.6	2,025.5	1,991.4	1,853.4	1,782.5	1,880.3	2,153.9	2,285.5	2,415.9
Contributions to government employee retirement plans	–4.5	–4.4	–4.3	–4.5	–4.8	–4.7	–4.6	–4.6	–4.6	–4.5	–4.5	–4.3
Capital transfers received	–17.1	–19.7	–23.9	–27.6	–28.8	–28.2	–26.3	–21.7	–24.7	–24.6	–27.4	–23.5
Other coverage differences	–3.6	–3.9	–5.8	–7.0	–8.0	–7.9	–8.9	–9.1	–10.0	–11.3	–11.9	–12.7
Netting and grossing	62.8	69.5	64.5	65.7	70.6	69.9	77.0	84.9	89.0	71.0	112.9	120.8
Timing differences	1.8	5.5	1.1	–3.9	–13.2	6.7	–25.6	23.1	4.9	5.9	15.3	24.6
NIPA current receipts	1,492.7	1,626.4	1,753.5	1,850.3	2,041.2	2,027.1	1,865.0	1,855.1	1,934.9	2,190.4	2,369.9	2,520.6
EXPENDITURES												
Budget outlays	1,560.6	1,601.3	1,652.7	1,702.0	1,789.2	1,863.2	2,011.2	2,160.1	2,293.0	2,472.2	2,708.7	2,770.1
Government employee retirement plan transactions	26.8	31.6	31.3	32.1	31.7	31.5	33.7	32.5	32.8	39.8	40.4	40.7
Deposit insurance and other financial transactions	2.3	–6.4	–7.1	–6.1	–9.0	–6.2	–6.7	1.7	1.1	4.8	–16.2	–9.3
Capital transfer payments	–27.7	–28.9	–28.2	–31.3	–35.1	–39.8	–44.1	–45.5	–46.3	–47.4	–50.6	–55.6
Net purchases of nonproduced assets	0.1	11.0	5.3	1.7	0.2	0.9	–0.2	–.0	–0.1	–0.1	–0.2	19.5
Net investment	0.9	9.3	7.6	5.7	6.0	7.9	1.4	–1.9	–6.2	–7.2	–9.2	–4.4
Other coverage differences	3.1	11.4	1.0	2.7	4.0	7.9	–0.6	–13.2	–18.5	–26.5	–18.0	–3.7
Netting and grossing differences	62.8	69.5	64.5	65.7	70.6	69.9	77.0	84.9	89.0	71.0	112.9	120.8
Timing differences	9.9	–5.4	–0.7	–4.7	–5.6	14.3	–6.7	–2.6	3.8	19.6	–16.6	13.0
NIPA current expenditures	1,638.9	1,693.5	1,726.5	1,767.8	1,852.0	1,949.3	2,064.9	2,216.0	2,348.5	2,526.2	2,751.2	2,891.0
ADDENDUM												
Budget surplus or deficit (–)	–107.4	–21.9	69.3	125.6	236.2	128.2	–157.8	–377.6	–412.7	–318.3	–423.2	–354.2
NIPA net Federal Government saving	–146.1	–67.1	27.0	82.4	189.2	77.8	–199.9	–361.0	–413.6	–335.8	–381.3	–370.4

* $50 million or less.

of financial transaction—direct loans to the public—has been recorded in the budget in a way that is closer to the NIPA treatment. Disbursement and repayment of loans made since that time are recorded outside the budget as in the Federal sector of the NIPAs, although, unlike the NIPAs, credit subsidies are recorded as budget outlays.

During the period 1975–1992, the budget deficit was a larger negative number than net Federal Government saving as measured in the NIPAs every year. The largest difference, $78.8 billion, occurred in 1991 as a result of resolving failed financial institutions as discussed above; the budget deficit was then –$269.2 billion, while the NIPA net Government saving was –$190.5 billion. In 1993–2002, the NIPA net Federal Government saving was a larger negative number than the budget deficit or lower positive number than the budget surplus each year. For 2003–2004, and in the estimate for 2006, though not for 2005 or 2007, the NIPA net Federal Government saving is a smaller negative number than the budget deficit.

Table 14–1 displays Federal transactions using NIPA concepts with actual data for 1996–2005 and estimates for 2006 and 2007 consistent with the Administration's budget proposals. Table 14–2 summarizes the reasons for differences between the data. Table 14–3 displays quarterly data beginning with the last quarter of 2004 based on NIPA concepts. Annual NIPA data for 1948–2007 are published in Section 14 of a separate budget volume, *Historical Tables, Budget of the U.S. Government, Fiscal Year 2007.*

Detailed estimates of NIPA current receipts and expenditures consistent with the budget will be published in a forthcoming issue of the Department of Commerce publication, *Survey of Current Business* and on the Bureau of Economic Analysis website at *http://www.bea.doc.gov/bea/pubs.htm.*

Table 14–3. FEDERAL RECEIPTS AND EXPENDITURES IN THE NIPA's, QUARTERLY, 2005–2007

(in billions of dollars; seasonally adjusted at annual rates)

Description	Actual				Estimate							
	Oct.-Dec. 2004	Jan.-Mar. 2005	Apr.-June 2005	July-Sept. 2005	Oct.-Dec. 2005	Jan.-Mar. 2006	Apr.-June 2006	July-Sept. 2006	Oct.-Dec. 2006	Jan.-Mar. 2007	Apr.-June 2007	July-Sept. 2007
CURRENT RECEIPTS												
Current tax receipts	1,181.3	1,305.1	1,331.8	1,338.7		1,375.3	1,384.4	1,409.9	1,435.7	1,474.3	1,498.7	1,522.3
Personal current taxes	839.7	908.3	924.3	940.5		996.6	1,009.2	1,038.3	1,065.5	1,100.3	1,123.3	1,144.3
Taxes on production and imports	95.1	95.4	98.3	97.5		97.4	99.5	100.7	102.8	103.7	104.2	104.6
Taxes on corporate income	235.3	291.7	300.8	290.7		271.3	265.7	260.8	257.5	260.3	261.1	263.3
Taxes from the rest of the world	11.2	9.7	8.5	10.0		10.0	10.0	10.0	10.0	10.0	10.0	10.0
Contributions for government social insurance	823.4	841.1	845.1	852.6		888.2	902.2	915.9	928.4	947.9	956.7	965.8
Income receipts on assets	22.2	23.0	24.3	22.8		24.8	25.7	26.5	26.3	25.8	25.2	25.8
Current transfer receipts	30.0	30.4	30.2	–61.4		33.2	33.7	34.0	33.9	33.9	33.9	33.7
Current surplus of government enterprises	–2.3	–2.9	–3.6	–4.3		–2.9	–4.1	–5.7	–5.7	–6.3	–6.4	–6.8
Total current receipts	2,054.6	2,196.6	2,227.9	2,148.5		2,318.6	2,342.0	2,380.7	2,418.6	2,475.6	2,508.1	2,540.9
CURRENT EXPENDITURES												
Consumption expenditures	735.1	759.6	762.8	782.9		816.2	826.9	825.5	820.6	823.4	822.9	822.8
Defense	490.1	508.9	512.3	528.6		549.8	558.1	555.3	549.4	551.4	550.0	549.0
Nondefense	245.1	250.7	250.5	254.3		266.4	268.9	270.1	271.2	272.0	272.9	273.8
Current transfer payments	1,419.0	1,458.7	1,459.9	1,474.4		1,576.9	1,584.8	1,591.2	1,625.9	1,649.5	1,673.9	1,699.9
Government social benefits	1,034.9	1,064.2	1,077.9	1,094.4		1,188.9	1,191.2	1,194.8	1,225.4	1,262.8	1,282.5	1,302.0
Grants-in-aid to State and local governments	358.7	356.1	358.6	354.1		356.2	363.9	368.1	365.2	364.7	368.1	372.9
Other transfers to the rest of the world	25.3	38.3	23.5	25.9		31.8	29.7	28.2	35.3	22.0	23.3	25.0
Interest payments	226.1	226.6	250.8	250.8		277.8	286.9	295.5	303.0	310.8	318.3	325.5
Subsidies	46.1	50.1	51.6	55.6		59.4	61.4	62.9	63.0	63.8	64.6	65.4
Wage disbursements less accruals	....	....	....	....		....	....	....	....	....	....	....
Total current expenditures	2,426.2	2,494.9	2,525.2	2,563.7		2,730.3	2,760.1	2,775.0	2,812.5	2,847.5	2,879.7	2,913.6
Net Federal Government saving	–371.6	–298.3	–297.3	–415.2		–411.7	–418.0	–394.3	–393.9	–371.9	–371.6	–372.8
ADDENDUM: TOTAL RECEIPTS AND EXPENDITURES												
Current receipts	2,054.6	2,196.6	2,227.9	2,148.5		2,318.6	2,342.0	2,380.7	2,418.6	2,475.6	2,508.1	2,540.9
Capital transfer receipts	23.9	24.9	24.4	25.1		26.5	26.6	26.1	25.1	22.8	21.4	19.7
Total receipts	2,078.5	2,221.5	2,252.3	2,173.6		2,345.0	2,368.6	2,406.8	2,443.7	2,498.4	2,529.5	2,560.6
Current expenditures	2,426.2	2,494.9	2,525.2	2,563.7		2,730.3	2,760.1	2,775.0	2,812.5	2,847.5	2,879.7	2,913.6
Net investment:												
Gross government investment:												
Defense	71.9	66.4	70.2	73.1		72.6	75.5	74.9	75.1	74.9	75.6	74.7
Nondefense	33.8	34.3	36.8	36.3		38.4	39.0	39.5	39.8	39.8	39.7	39.4
Less: Consumption of fixed capital:												
Defense	66.2	66.8	67.5	68.2		69.6	70.3	71.0	71.7	72.4	73.2	73.9
Nondefense	29.7	30.0	30.3	30.9		32.0	32.8	34.0	34.8	35.6	36.4	37.6
Capital transfer payments	61.8	80.0	67.1	64.2		69.0	69.5	71.0	72.8	74.4	75.3	77.4
Net purchases of nonproduced assets	–1.0	0.3	–0.6	–1.6		0.1	0.2	0.2	–19.5	–19.5	–19.5	–19.5
Total expenditures	2,496.8	2,578.9	2,601.0	2,636.5		2,808.8	2,841.1	2,855.5	2,874.2	2,909.2	2,941.3	2,974.2
Net lending or net borrowing (–)	–418.2	–357.4	–348.7	–462.9		–463.8	–472.5	–448.8	–430.5	–410.8	–411.8	–413.6

Department of Commerce advance estimates for the Oct.-Dec. 2005 quarter, released January 27, 2006, were not available in time for inclusion in this table.
* $50 million or less.

BUDGET REFORM PROPOSALS

15. BUDGET REFORM PROPOSALS

The budget process should be transparent, accountable, and orderly. The current budget process could benefit from reforms that help achieve these goals. No one change can fix the budget process, and process alone cannot address important fiscal issues. Nevertheless, process changes can be a key factor in the effort to control spending. Starting with *A Blueprint for New Beginnings* and continuing with subsequent budgets, this Administration has consistently proposed changes to the budget process that are designed to improve budget decisions and outcomes. This chapter updates the Administration's proposals and describes additional reforms proposed by the Administration.

Controlling Entitlements and Other Mandatory Spending

Mandatory Spending Control.—The Administration proposes to require that all legislation that changes mandatory spending, in total, does not increase the deficit. The five-year impact of any proposals affecting mandatory spending would continue to be scored. Legislation that increases the current year and the budget year deficit would trigger a sequester of direct spending programs. The proposal does not apply to changes in taxes and does not permit mandatory spending increases to be offset by tax increases. Table 15–1 displays the President's mandatory spending proposals.

Long-term Unfunded Obligations.—The Administration proposes new measures to address the long-term unfunded obligations of Federal entitlement programs. As discussed in Chapter 13 of this volume, "Stewardship," spending by the Government's major entitlement programs, particularly Social Security and Medicare, is projected to rise in the next few decades to levels that cannot be sustained, either by those programs' own dedicated financing or by general revenues. The Administration's proposed measures are designed to begin addressing these challenges.

In the Medicare Modernization Act (MMA) of 2003, Congress provided for a more comprehensive review of the Medicare program's finances and required the Medicare trustees to issue a warning when general revenue Medicare funding is projected to exceed 45 percent of Medicare's total expenditures. The President's Budget proposes to build on this reform by requiring an automatic reduction in the rate of Medicare growth if the MMA threshold is exceeded. The reduction would begin as a four-tenths of a percent reduction to all payments to providers in the year the threshold is exceeded, and would grow by four-tenths of a percent every year the shortfall continued to occur. This provision is designed to encourage the President and the Congress to reach agreement on reforms to slow Medicare spending and bring it back into line with the threshold established by the MMA.

In addition to this Medicare-specific control mechanism, the President's Budget proposes to establish a broader enforcement measure to analyze the long-term

Table 15–1. MANDATORY PROPOSALS

(Cost/Savings (–) in millions of dollars)

	2006	2007	2008	2009	2010	2011	Total, 2006–11
Medicare	....	–2,452	–5,485	–7,948	–9,343	–10,663	–35,891
Pension Benefit Guaranty Corporation Reform	....	....	–4,195	–4,181	–4,164	–4,140	–16,680
Outlay Effects of Tax Proposals [1]	....	532	871	1,243	1,375	1,519	5,540
Commodity Program Changes	....	–1,081	–1,079	–945	–965	–917	–4,988
Arctic National Wildlife Refuge, Lease Bonuses	....	....	–3,502	–2	–503	–3	–4,010
User Fee Proposals	....	–315	–488	–610	–614	–718	–2,745
Grants to States for Chronically Ill	....	250	375	493	506	523	2,146
Unemployment Insurance Integrity Legislation	....	....	–482	–515	–365	–376	–1,738
Temporary Assistance for Needy Families	....	40	149	425	473	488	1,575
Federal Employee Health Benefits Program	....	–34	–134	–231	–306	–367	–1,072
Medicaid/State Children's Health Insurance Program	....	504	–190	–523	–691	–567	–1,467
Cover the Kids	....	100	100	100	100	100	500
Other Proposals	69	84	–143	–115	–284	–362	–751
Total	69	–2,372	–14,203	–12,811	–14,781	–15,843	–59,580
Total, 2006 and 2007	....	–2,303	....	....	....	....	....
Memorandum: Further Hurricane Response							
National Flood Insurance (emergency)	*5,040*	*560*	....	....	....	....	*5,600*

[1] Affects both receipts and outlays. Only the outlay effect is shown here.

impact of legislation on the unfunded obligations of major entitlement programs and to make it more difficult to enact legislation that would expand the unfunded obligations of these programs over the long-run. These measures would highlight proposed legislative changes that appear to cost little in the short run but result in large increases in the spending burdens passed on to future generations.

First, the Administration proposes a point of order against legislation which worsens the long-term unfunded obligation of major entitlements. The specific programs covered would be those programs with long term actuarial projections, including Social Security, Medicare, Federal civilian and military retirement, veterans disability compensation, and Supplemental Security Income. Additional programs would be added once it becomes feasible to make long-term actuarial estimates for those programs.

Second, the Administration proposes new reporting requirements to highlight legislative actions worsening unfunded obligations. These requirements would require the Administration to report on any enacted legislation in the past year that worsens the unfunded obligations of the specified programs.

Budget Discipline for Agency Administrative Actions.—A significant amount of Federal policy is made via administrative action, which can increase Federal spending, often on the order of tens of billions of dollars in entitlement programs such as Medicare or Medicaid. Although known costs are incorporated into the budget baselines of various programs, agencies frequently initiate unplanned for and costly proposals. Often, these costs are not reflected in the baseline, or are not accompanied by other actions that would pay for the proposed change. This results in increased spending and deficits.

Controlling these costs is integral to the Administration's commitment to reducing the deficit and enforcing fiscal discipline. Toward that end, the Director of the Office of Management and Budget issued on May 23, 2005 a memorandum to all Executive Branch agencies implementing a budget-neutrality requirement on agency administrative actions affecting mandatory spending. Discretionary administrative actions in entitlement programs, including regulations, program memoranda, demonstrations, guidance to States or contractors, and other similar changes to entitlement programs are generally required to be fully offset. Exceptions to this requirement are only provided in extraordinary or compelling circumstances.

Controlling Discretionary Spending

Discretionary Caps.—The Administration proposes to set limits for 2006 through 2011 on net discretionary budget authority and outlays equal to the levels proposed in the 2007 Budget. Legislation that exceeds the discretionary caps would trigger a sequester of non-exempt discretionary programs. Table 15–2 displays the total levels of discretionary budget authority and outlays proposed for 2006 through 2011. This approach would put in place a budget framework for the next five years that ensures constrained, but reasonable growth in discretionary programs. For 2006 through 2008, separate defense (Function 050) and nondefense categories would be enforced. For 2009–2011, there would be a single cap for all discretionary spending. In addition, a separate category for transportation outlays financed by dedicated revenues would be established for 2006 through 2009 at levels consistent with those enacted in the Safe, Accountable, Flexible, Efficient, Transportation Equity Act: A Legacy for Users (SAFETEA–LU).

Program Integrity Cap Adjustments.—An improper payment occurs when Federal funds go to the wrong recipient, the recipient receives an incorrect amount of funds, or the recipient uses the funds in an improper manner. Approximately 86 percent of improper payments are overpayments. The Administration has made the elimination of improper payments a major focus. Federal agencies have aggressively reviewed Federal programs to evaluate the risk of improper payments and have developed measures to assess the extent of improper payments. Processes and internal control improvements have been initiated to enhance the accuracy and integrity of payments and to report the results of these efforts, pursuant to the Improper Payments Information Act of 2002 (P.L. 107–300).

The results of the agency assessment have been aggregated into a Government-wide report entitled *Improving the Accuracy and Integrity of Federal Payments*. (The full text of the report can be found at *http://www.whitehouse.gov/omb/financial/fia_improper.html*.) In 2005, the agencies reported a total of $37.3 billion in improper payments. This represents a 3.3 percent improper payment rate. Nearly 80 percent of those improper payments are in four programs: Medicare, Earned Income Tax Credit, Old-Age, Survivors, and Disability Insurance, and Unemployment Insurance.

In the context of the Administration's efforts to eliminate improper payments, the Administration is proposing adjustments for spending above a base level of funding within the discretionary levels for several program integrity initiatives, specifically for continuing disability reviews (CDRs) in the Social Security Administration, Internal Revenue Service (IRS) tax enforcement, the Health Care Fraud and Abuse Control Program (HCFAC) in the Centers for Medicare and Medicaid Services and Unemployment Insurance improper payments in the Department of Labor. These cap adjustments provide an effective way to ensure that limited resources are applied to activities that reduce errors and generate program savings.

In the past decade, there have been a variety of successful efforts to ensure dedicated resources for program integrity efforts. These efforts include cap adjustment funding for Social Security continuing disability reviews and integrity efforts associated with the Earned Income Tax Credit (EITC). These initiatives have led to increased savings for the Social Security and Supplemental Security Income programs and an increase in enforcement efforts in EITC. For example, the Social

Table 15–2. DISCRETIONARY CAPS AND ADJUSTMENTS

(Amounts in billions of dollars)

	2006[1]	2007	2008	2009	2010	2011
Proposed Discretionary Spending Categories:						
Discretionary Category:						
Defense Category (Function 050):						
Budget authority	432.4	459.7	482.1	NA	NA	NA
Outlays	502.2	468.4	467.9	NA	NA	NA
Nondefense Category:						
Budget authority	411.0	410.4	412.6	NA	NA	NA
Outlays	456.9	452.3	436.6	NA	NA	NA
Proposed Cap Adjustments:						
SSA Continuing Disability Reviews:						
Budget authority	NA	0.201	0.213	NA	NA	NA
Outlays	NA	0.201	0.213	NA	NA	NA
IRS Tax Enforcement:						
Budget authority	NA	0.137	0.207	NA	NA	NA
Outlays	NA	0.129	0.203	NA	NA	NA
Health Care Fraud and Abuse Control:						
Budget authority	NA	0.118	0.183	NA	NA	NA
Outlays	NA	0.118	0.183	NA	NA	NA
Unemployment Insurance Improper Payments:						
Budget authority	NA	0.040	0.040	NA	NA	NA
Outlays	NA	0.034	0.040	NA	NA	NA
Subtotal, Nondefense Category, with Adjustments:						
Budget authority	411.0	410.9	413.3	NA	NA	NA
Outlays	456.9	452.7	437.3	NA	NA	NA
Discretionary Category:						
Budget authority	NA	NA	NA	916.6	928.4	940.5
Outlays	NA	NA	NA	916.1	979.1	992.5
Highway Category:						
Outlays	33.5	37.1	38.7	39.9	NA	NA
Mass Transit Category:[2]						
Outlays	5.8	7.3	8.5	9.3	NA	NA
Total, All Discretionary Categories:						
Budget authority	843.3	870.7	895.4	916.6	928.4	940.5
Outlays	998.3	965.6	952.3	965.3	979.1	992.5
Project BioShield Category:						
Budget authority	....	....	....	2.2	....	....
Memorandum: 2006 Enacted Emergency Supplementals						
Budget authority	*58.4*	....	....	....	....	....

[1] The discretionary emergency budget authority provided in Division A, Title IX, and in Division B of the Department of Defense Appropriations Act, 2006 (P.L. 109–148) for: Defense contingency operations related to the Global War on Terror, response to the Gulf Coast Hurricanes, and pandemic influenza preparedness is displayed separately on a memorandum line.

[2] Includes outlays from discretionary budget authority.

Security Administration reports that every $1 expended on CDRs has produced a $10 return to taxpayers. The Administration's proposed adjustments for program integrity activities will total $496 million in budget authority in 2007 and $643 million in budget authority in 2008.

Transportation Category.—The Administration's proposal for discretionary caps includes separate outlay categories for spending on Federal Highway and Mass Transit programs that are consistent with the funding levels enacted in SAFETEA–LU. The transportation levels will be financed by dedicated revenues through 2009. Table 15–3 shows the levels, taking into account the revenue aligned budget authority (RABA) adjustment as authorized in SAFETEA–LU. The RABA adjustment is calculated based on changes in estimated Highway Trust Fund receipts, and results in either an increase or decrease in the Highway Category funding level enacted in SAFETEA–LU. For 2007, the RABA adjustment is a positive $842 million.

Advance Appropriations.—An advance appropriation becomes available one or more years beyond the year for which its appropriations act is passed. Budget authority is recorded in the year the funds become available and not in the year of enactment. Too often, advance appropriations have been used to expand spend-

Table 15–3. TRANSPORTATION CATEGORY FOR HIGHWAYS AND MASS TRANSIT SPENDING

(Amounts in billions of dollars)

	2006	2007	2008	2009
Transportation Category: [1]				
Highways: [2]				
Obligation Limitations	36.8	40.4	40.9	42.6
Outlays	33.5	37.1	38.7	39.9
Mass Transit:				
Obligation Limitations	6.9	7.3	7.9	8.4
Outlays [3]	5.8	7.3	8.5	9.3
Memorandum:				
Discretionary budget authority for Mass Transit included in the Nondefense Category:				
Budget authority	*1.6*	*1.6*	*1.9*	*2.0*

[1] The SAFETEA–LU levels enacted for Highway and Mass Transit programs apply through 2009.

[2] Includes adjustments to levels authorized in SAFETEA–LU of $842 million in 2007 for revenue aligned budget authority (RABA) calculation and $122 million in FY 2007–2009 for National Highway Traffic Safety Administration (proposal to fund NHTSA completely from the Highway Trust Fund instead of portion from General Fund, as authorized in SAFETEA–LU).

[3] Includes outlays from discretionary budget authority.

ing levels by shifting budget authority from the budget year into the subsequent year and then appropriating the budget authority freed up under the budget year discretionary cap to other programs. The effect of these advance appropriations is to limit the amount of discretionary budget authority available in subsequent years, thereby reducing future funding options available to both Congress and the President. From 1993 to 1998, an average of $2.3 billion in discretionary budget authority was advance appropriated each year. In 1999, advance appropriations totaled $8.9 billion and increased to $23.4 billion in 2000.

Because this budget practice distorts the debate over Government spending and misleads the public about spending levels in specific accounts, the President's budget proposals and the 2002 Congressional Budget Resolution capped advance appropriations at the amount advanced in the previous year. By capping advance appropriations, increases in these and other programs can be budgeted and reflected in the year of their enactment. For 2008, the Administration proposes a cap on advance appropriations of $23,715 million, which includes the Department of Energy's FutureGen project and an already enacted advance appropriation for the Corporation for Public Broadcasting.

In addition, the Administration proposes to score the second year effect of appropriations language that delays obligations of mandatory budget authority as advance appropriations that count against the discretionary caps. Appropriations acts often include provisions that delay obligations of mandatory BA from one year to the next. The first year is appropriately scored as a discretionary savings because it is included in an appropriations act and it reduces spending in that year. However, this is usually a temporary delay, and the funds become available for spending in the second year. Under this proposal, the second year impact would be treated as an advance appropriation and scored against the discretionary caps. This would correct an inconsistency in the current practice where savings are scored in the first year, but the second year impact is reclassified in the subsequent budget as mandatory and not scored against the discretionary caps.

To enforce the level of advance appropriations, the discretionary cap proposal provides that total funding for advance appropriations (including obligation delays) provided in an appropriations act for 2008 that is in excess of the Administration's limit on advance appropriations of $23,715 million in 2008 will count against the discretionary cap in the year enacted, not against the year the funds first become available.

Federal Pell Grants.—To ensure funding shortfalls do not accumulate in the Pell Grant program in future years, the 2006 Congressional Budget Resolution adopted the Administration's proposal to score appropriations at the amount needed to fully fund the award level set in appropriations acts, beginning with the 2006–2007 school year, if the amount appropriated is insufficient to fully fund all awards. The Administration proposes to continue this scoring rule. Under this rule, the amount scored would be increased to cover any cumulative funding shortfalls from previous years and reduced by any surpluses carried over from previous years, beginning with any shortfalls or surpluses from the 2006–2007 school year. If the amount appropriated exceeds the estimated full cost, the amount appropriated would be scored against that year, and the surplus would carry over as a credit against the following year's cost estimate. In the 2007 Budget, the Department of Education estimates that a cumulative $273 million surplus will be carried into the 2007–2008 academic year. For scoring purposes, the funding needed to fully fund all awards for 2007–2008 is reduced by the amount of this surplus.

Project BioShield Category.—The Administration proposes a separate BEA category for budget authority for Project BioShield, which received an advance appropriation for 2005 of $2.5 billion and for 2009 of $2.2 billion in P.L. 108–90, the 2004 Department of Homeland Security Appropriations Act. Because the success of this program in providing for the development of vaccines and medications for biodefense depends on an assured funding availability, it is critical that this funding not be diverted to other purposes. The Administration's proposal to create a separate category will help ensure that funding for this program is not reduced and used as an offset for other discretionary spending.

Include Stricter Standard For Emergency Designation in the BEA

When the BEA was created, it provided a "safety valve" to ensure that the fiscal constraint envisioned by the BEA would not prevent the enactment of legislation to respond to unforeseen disasters and emergencies such as Operation Desert Storm, the terrorist attacks of September 11, 2001, or Hurricane Katrina. If the President and the Congress separately designated a spending or tax item as an emergency requirement, the BEA held these items harmless from its enforcement mechanisms. Initially, this safety valve was used judiciously, but in later years its application was expanded to circumvent the discretionary caps by declaring spending for ongoing programs as "emergencies."

The Administration proposes to include in the BEA a definition of "emergency requirement" that will ensure high standards are met before an event is deemed an "emergency" and therefore exempt. This definition should include the following elements: the requirement is a necessary expenditure that is sudden, urgent, unforeseen, and not permanent. These elements, all of which would be used for defining something as an emergency, are defined as follows:

- **necessary expenditure**—an essential or vital expenditure, not one that is merely useful or beneficial;
- **sudden**—quickly coming into being, not building up over time;
- **urgent**—pressing and compelling, requiring immediate action;
- **unforeseen**—not predictable or seen beforehand as a coming need (an emergency that is part of the average annual level of disaster assistance funding would not be "unforeseen"); and
- **not permanent**—the need is temporary in nature.

This definition codifies the criteria for an emergency that have been the standard for a number of years. It is designed to preclude funds from being declared an emergency for events that occur on an annual or recurring basis. For example, even though it is not possible to predict the specific occurrence of fires, tornados, hurricanes, and other domestic disasters, it is reasonable to assume that a combination of domestic disasters will occur in any given year that require funding equal to a multi-year average for disaster relief. Funding at an average, therefore, should not be considered an emergency under this definition. On the other hand, an average level of funding for domestic disasters will not accommodate the level necessary to address a large and relatively infrequent domestic disaster, such as Hurricane Katrina. Under this definition for emergencies, spending for extraordinary events could be classified as emergency funding. In the end, classification of certain spending as an emergency depends on common sense judgment, made on a case-by-case basis, about whether the totality of facts and circumstances indicate a true emergency.

In addition, the Administration proposes that the definition of an emergency requirement also encompass contingency operations that are national security related. Contingency operations that are national security related include both defense operations and foreign assistance. Military operations and foreign aid with costs that are incurred regularly should be a part of base funding and, as such, are not covered under this definition.

The Administration proposal also would require that the President and Congress concur in designating an emergency for each spending proposal covered by a designation. This would protect against the "bundling" of non-emergency items with true emergency spending. If the President determines that specific proposed emergency designations do not meet this definition, he would not concur in the emergency designation and no discretionary cap adjustment or mandatory spending control exemption would apply.

Baseline

The Administration proposes several changes to Section 257 of the BEA, which establishes the requirements for the baseline:

- Assume extension of all expiring tax provisions in the Economic Growth and Tax Relief Reconciliation Act of 2001 and certain provisions in the Jobs and Growth Tax Relief Reconciliation Act of 2003. This proposal is consistent with the BEA baseline rules for expiring mandatory spending and for excise taxes dedicated to a trust fund. Except for a few relatively small mandatory programs, the BEA assumes that mandatory spending and excise taxes dedicated to a trust fund will be reauthorized and extends them in the baseline. The 2001 Act and 2003 Act provisions were not intended to be temporary, and not extending them in the baseline raises inappropriate procedural road blocks to extending them at current rates.
- Add a provision to exclude discretionary funding for emergencies from the baseline. Instead, the baseline would include emergency funding only for the year in which it was enacted. The current requirement is for the discretionary baseline estimates for the budget year and the outyears to assume the current year appropriated level, adjusted for inflation. This is reasonable for ongoing programs, where the need is expected to continue

into the future. For emergencies, since the need should be for a short duration, the baseline rules build unnecessary funding into the baseline estimates for the years after the need has been addressed and passed. In effect, the current rule biases the baseline in favor of higher discretionary spending.

- Correct the overcompensation of baseline budgetary resources for pay raise-related costs due to the way in which these costs are inflated. The current requirement, which provides a full year's funding for pay raises in the budget year and beyond, was written when Federal pay raises were scheduled to take effect on October 1, at the start of each fiscal year. However, this requirement is now inappropriate because the effective date for pay raises is now permanently set by law as the first pay period in January. By treating pay raises that begin on January 1 as if they take effect for the entire fiscal year, the baseline overstates the cost of providing a constant level of services.
- Eliminate the adjustments for expiring housing contracts and social insurance administrative expenses. Most multi-year housing contracts have expired or have been addressed since the BEA was first enacted in 1990, so the adjustment is no longer needed. The adjustment for social insurance administrative expenses is also inconsistent with the baseline rules for other accounts that fund the costs of administration. These programs should not be singled out for preferential treatment.

Line-Item Veto

A perennial criticism of the Federal Government is that spending and tax legislation contain too many provisions benefiting a relative few which would likely not become law if considered as a stand-alone bill. The persistence of special interest items diverts resources from higher priority programs and erodes the confidence of citizens in Government. Appropriations bills, especially those considered at the end of the congressional session, often attract special interest spending items that could not be enacted on their own.

The President proposes that Congress correct this state of affairs by providing him and future presidents with a line item veto that would withstand constitutional challenge. From the Nation's founding, presidents have exercised the authority to not spend appropriated sums. However, Congress sought to curtail this authority in 1974 through the Impoundment Control Act, which restricted the President's authority to decline to spend appropriated sums. Although the Line Item Veto Act of 1996 attempted to give the President the authority to cancel spending authority and special interest tax breaks, the U.S. Supreme Court found that law unconstitutional. The President's proposal would correct the constitutional flaw in the 1996 Act.

Specifically, the President proposes a line-item veto linked to deficit reduction. This proposal would give the President the authority to defer new spending whenever the President determines the spending is not an essential Government priority. All savings from the line-item veto would be used for deficit reduction, and they could not be applied to augment other spending.

Other Budget Reform Proposals

Joint Budget Resolution.—A joint budget resolution would set the overall levels for discretionary spending, mandatory spending, receipts, and debt in a simple document that would have the force of law. Under the current process, the Congress annually adopts a "concurrent resolution," which does not require the President's signature and does not have the force of law.

A joint budget resolution could be enforced by sequesters requiring automatic across-the-board cuts to offset any excess spending, similar to the BEA. It would bring the President into the process at an early stage, encourage the President and the Congress to reach agreement on overall fiscal policy before individual tax and spending bills are considered, and give the budget resolution the force of law.

Biennial Budgeting and Appropriations.—Only once in the last 25 years have all appropriation bills been enacted by the beginning of the fiscal year. Because Congress must enact these bills each year, it cannot devote the time necessary to provide oversight and fully address problems in Federal programs. The preoccupation with these annual appropriations bills frequently precludes review and action on authorization legislation and on the growing portion of the budget that is permanently funded under entitlement laws. According to the Congressional Budget Office, the Congress has appropriated about $159 billion for 2006 for programs and activities whose authorizations of appropriations have expired.

In contrast, a biennial budget would allow lawmakers to devote more time every other year to ensuring that taxpayers' money is spent wisely and efficiently. In addition, Government agencies would receive more stable funding, which would facilitate longer range planning and improved fiscal management. Under the President's proposal for a biennial budget, funding decisions would be made in odd-numbered years, with even numbered years devoted to authorizing legislation.

Government Shutdown Prevention.—In the 24 out of the past 25 years in which Congress has not finished appropriation bills by the October 1st deadline, it has funded the Government through "continuing resolutions" (CRs), which provide temporary funding authority for Government activities, usually at current levels, until the final appropriations bills are signed into law.

If Congress does not pass a CR or the President does not sign it, the Federal Government must shut down. Important Government functions should not be held hostage simply because of an impasse over temporary funding bills. There should be a back-up plan to avoid the threat of a Government shutdown, although the expectation is that appropriations bills still would pass on time as the law requires. Under the

Administration's proposal, if an appropriations bill is not signed by October 1 of the new fiscal year, funding would be automatically provided at the lower of the President's Budget or the prior year's level.

Results and Sunset Commissions.—The Federal Government's ability to serve the American people is often hampered by poorly designed programs or uncoordinated, overlapping programs trying to achieve the same objective. Today, almost 30 percent of assessed programs have been determined to be either ineffective or unable to demonstrate results. And the problem of overlapping programs exists in many areas where the Government is trying to serve.

From the 1930s through 1984, presidents were permitted to submit plans for reorganizing Federal agencies to Congress that would become effective unless the plan was disapproved by either House of Congress. After the Supreme Court decision in *INS v. Chadha* (462 U.S. 919), the authority granted to presidents for submitting reorganization plans under the Reorganization Act (5 U.S.C. 903) was limited by the requirement of congressional approval through a joint resolution and by the scope of what could be proposed. This authority was no longer available to the President after 1984.

Today, proposals to restructure or consolidate programs or agencies so they can perform better require a change in law and often face long odds of being enacted due to a cumbersome process that requires approval from multiple congressional committees.

To address this problem, last year the Administration transmitted the Government Reorganization and Program Performance Improvement Act, which would establish bipartisan Results Commissions and a Sunset Commission. Results Commissions would consider and revise Administration proposals to restructure or consolidate programs or agencies to improve their performance. The Sunset Commission would consider Presidential proposals to retain, restructure, or terminate agencies and programs according to a schedule set by the Congress. Agencies and programs would automatically terminate according to the schedule unless reauthorized by the Congress.

FEDERAL BORROWING AND DEBT

16. FEDERAL BORROWING AND DEBT

Debt is the largest legally binding obligation of the Federal Government. At the end of 2005, the Government owed $4,592 billion of principal to the people who had loaned it the money to pay for past deficits. During that year, the Government paid the public around $191 billion of interest on this debt.

Table 16–1. TRENDS IN FEDERAL DEBT HELD BY THE PUBLIC

(Dollar amounts in billions)

Fiscal Year	Debt held by the public:		Debt held by the public as a percent of:		Interest on the debt held by the public as a percent of: [3]	
	Current Dollars	FY 2000 dollars [1]	GDP	Credit market debt [2]	Total outlays	GDP
1946	241.9	1,821.3	108.6	N/A	7.4	1.8
1950	219.0	1,339.9	80.2	53.3	11.4	1.8
1955	226.6	1,217.3	57.4	43.2	7.6	1.3
1960	236.8	1,128.0	45.7	33.8	8.5	1.5
1965	260.8	1,161.4	38.0	26.9	8.1	1.4
1970	283.2	1,047.8	28.0	20.8	7.9	1.5
1975	394.7	1,074.6	25.3	18.4	7.5	1.6
1980	711.9	1,340.7	26.1	18.5	10.6	2.3
1985	1,507.3	2,164.6	36.4	22.3	16.2	3.7
1990	2,411.6	2,968.1	42.0	22.6	16.1	3.5
1991	2,689.0	3,190.0	45.3	24.1	16.2	3.6
1992	2,999.7	3,471.2	48.1	25.7	15.5	3.4
1993	3,248.4	3,675.4	49.4	26.6	14.9	3.2
1994	3,433.1	3,802.6	49.3	26.8	14.4	3.0
1995	3,604.4	3,910.1	49.2	26.7	15.8	3.3
1996	3,734.1	3,974.6	48.5	26.3	15.8	3.2
1997	3,772.3	3,946.3	46.1	25.4	15.7	3.1
1998	3,721.1	3,846.1	43.1	23.5	15.1	2.9
1999	3,632.4	3,705.9	39.8	21.5	13.8	2.6
2000	3,409.8	3,409.8	35.1	19.2	13.0	2.4
2001	3,319.6	3,243.1	33.0	17.7	11.6	2.1
2002	3,540.4	3,393.9	34.1	17.7	8.9	1.7
2003	3,913.4	3,678.7	36.2	18.0	7.5	1.5
2004	4,295.5	3,943.5	37.2	18.3	7.3	1.5
2005	4,592.2	4,102.8	37.4	17.9	7.7	1.6
2006 estimate	5,018.9	4,373.6	38.5	N/A	8.5	1.8
2007 estimate	5,391.5	4,597.6	39.2	N/A	9.4	1.9
2008 estimate	5,633.4	4,701.8	38.8	N/A	10.2	2.0
2009 estimate	5,859.4	4,789.6	38.3	N/A	10.5	2.0
2010 estimate	6,060.8	4,852.5	37.6	N/A	10.6	2.0
2011 estimate	6,285.9	4,927.6	37.1	N/A	10.6	2.0

N/A = Not available.

[1] Debt in current dollars deflated by the GDP chain-type price index with fiscal year 2000 equal to 100.

[2] Total credit market debt owed by domestic nonfinancial sectors, modified in some years to be consistent with budget concepts for the measurement of Federal debt. Financial sectors are omitted to avoid double counting, since financial intermediaries borrow in the credit market primarily in order to finance lending in the credit market. Source: Federal Reserve Board flow of funds accounts. Projections are not available.

[3] Interest on debt held by the public is estimated as the interest on Treasury debt securities less the "interest received by trust funds" (subfunction 901 less subfunctions 902 and 903). The estimate of interest on debt held by the public does not include the comparatively small amount of interest paid on agency debt or the offsets for interest on Treasury debt received by other Government accounts (revolving funds and special funds).

The deficit was $318 billion in 2005. This deficit, partially offset by other financing transactions totaling $22 billion, required the Government to increase its borrowing from the public by $297 billion last year. Debt held by the public rose from 37.2 percent of GDP at the end of 2004 to 37.4 percent at the end of 2005. The deficit is estimated to rise in 2006 before declining. Debt as a percentage of GDP is estimated to rise through 2007 before starting to decline gradually through 2011.

Trends in Debt Since World War II

Table 16–1 depicts trends in Federal debt held by the public from World War II to the present and estimates from the present through 2011. (It is supplemented for earlier years by Tables 7.1–7.3 in *Historical Tables*, which is published as a separate volume of the Budget.) As this table shows, Federal debt peaked at 108.6 percent of GDP in 1946, just after the end of the war. From then until the 1970s, because of an expanding economy as well as inflation, Federal debt as a percentage of GDP decreased almost every year. With households borrowing large amounts to buy homes and consumer durables, and with businesses borrowing large amounts to buy plant and equipment, Federal debt also decreased almost every year as a percentage of the total credit market debt outstanding. The cumulative effect was impressive. From 1950 to 1975, debt held by the public declined from 80.2 percent of GDP to 25.3 percent, and from 53.3 percent of credit market debt to 18.4 percent. Despite rising interest rates, interest outlays became a smaller share of the budget and were roughly stable as a percentage of GDP.

During the 1970s, large budget deficits emerged as spending surged and as the economy was disrupted by oil shocks and inflation. The nominal amount of Federal debt more than doubled, and Federal debt relative to GDP and credit market debt stopped declining after the middle of the decade. The growth of Federal debt accelerated at the beginning of the 1980s, due in large part to a deep recession, and the ratio of Federal debt to GDP grew sharply. The ratio of Federal debt to credit market debt also rose, though to a lesser extent. Interest outlays on debt held by the public, calculated as a percentage of either total Federal outlays or GDP, increased as well.

The growth of Federal debt held by the public was decelerating by the mid-1990s, however, and the debt declined markedly relative to both GDP and total credit market debt. The decline accelerated as surpluses emerged from 1997 to 2001. Debt fell steadily from 49.4 percent of GDP in 1993 to 33.0 percent in 2001; and it fell more unevenly from 26.8 percent of total credit market debt in 1994 to 17.7 percent in 2001 and 2002. Interest on this debt, relative to total outlays and GDP, declined as well. Interest as a share of outlays peaked at 16.5 percent in 1989 and then fell to 8.9 percent by 2002; interest as a percentage of GDP fell in a similar proportion.

The downward trend in debt relative to GDP ceased as economic conditions changed and the September 11 terrorist attacks occurred. The decline in the stock market, the recession, and the initially slow recovery all reduced tax receipts; tax relief had the same effect; and spending increased for war and homeland security. As a result of the ensuing deficits, debt began to rise, both in nominal terms and as a percentage of GDP. Spending is also increasing in 2006, due in part to the rebuilding after Hurricane Katrina, but deficits are expected to begin to decline in 2007. As deficits are reduced, the increase in debt is estimated to slow. Debt is estimated to continue rising in nominal dollars, but to begin declining gradually after 2007 as a percent of GDP.

Debt Held by the Public, Gross Federal Debt, and Liabilities Other Than Debt

The Federal Government issues debt securities for two principal purposes. First, it borrows from the public to finance the Federal deficit.[1] Second, it issues debt to Government accounts, primarily trust funds, that accumulate surpluses. By law, trust fund surpluses must generally be invested in Federal securities. The gross Federal debt is defined to consist of both the debt held by the public and the debt held by Government accounts. Nearly all the Federal debt has been issued by the Treasury and is sometimes called "public debt," but a small portion has been issued by other Government agencies and is called "agency debt."[2]

Borrowing from the public, whether by the Treasury or by some other Federal agency, has a significant impact on the economy. Borrowing from the public is normally a good approximation of the Federal demand on credit markets. Regardless of whether the proceeds are used productively for tangible or intangible investment, the Federal demand on credit markets has to be financed out of the saving of households and businesses, the State and local sector, or the rest of the world. Federal borrowing thereby competes with the borrowing of other credit market sectors for financial resources in the credit market. Borrowing from the public thus affects the size and composition of assets held by the private sector and the perceived wealth of the public. It also increases the amount of future taxes required to pay interest to the public on Federal debt. Borrowing

[1] Debt held by the public was measured until 1988 as the par value (or face value) of the security, which is the principal amount due at maturity. (The only exception was savings bonds.) However, most Treasury securities are sold at a discount from par, and some are sold at a premium. Treasury debt held by the public is now measured as the sales price plus the amortized discount (or less the amortized premium). At the time of sale, the book value equals the sales price. Subsequently, it equals the sales price plus the amount of the discount that has been amortized up to that time. In equivalent terms, the book value of the debt equals par less the unamortized discount. (For a security sold at a premium, the definition is symmetrical.) When the measurement was changed, the data in *Historical Tables* were revised as far back as feasible, which was 1956. Agency debt, except for zero-coupon certificates, is recorded at par. For further analysis of these concepts, see Special Analysis E, "Borrowing and Debt," in *Special Analyses, Budget of the United States Government, Fiscal Year 1990*, pages E–5 to E–8, although some of the practices it describes have been revised. In 1997 Treasury began to sell inflation-indexed notes and bonds. The book value of these securities includes a periodic adjustment for inflation.

[2] The term "agency debt" is defined more narrowly in the budget than customarily in the securities market, where it includes not only the debt of the Federal agencies listed in Table 16–3 but also the debt of the Government-sponsored enterprises listed in table 7–9 at the end of Chapter 7 of this volume and certain Government-guaranteed securities.

Table 16–2. FEDERAL GOVERNMENT FINANCING AND DEBT

(In billions of dollars)

	Actual 2005	Estimate					
		2006	2007	2008	2009	2010	2011
Financing:							
Unified budget deficit (–)	–318.3	–423.2	–354.2	–223.3	–207.6	–182.7	–204.9
Financing other than the change in debt held by the public:							
Net purchases (–) of non-Federal securities by the National Railroad Retirement Investment Trust	–2.1	0.3	*	*	0.1	0.2	0.6
Changes in: [1]							
Treasury operating cash balance	0.7	....	....	....	....	....	....
Checks outstanding, etc. [2]	16.5	....	....	....	....	....	....
Seigniorage on coins	0.7	0.7	0.7	0.7	0.7	0.7	0.7
Less: Net financing disbursements:							
Direct loan financing accounts	–4.9	–16.1	–18.3	–18.8	–19.2	–19.4	–21.0
Guaranteed loan financing accounts	10.7	11.6	–0.8	–0.5	–0.1	–0.2	–0.5
Total, financing other than the change in debt held by the public	21.7	–3.5	–18.3	–18.6	–18.5	–18.7	–20.2
Total, requirement to borrow from the public	–296.7	–426.7	–372.6	–241.9	–226.0	–201.4	–225.1
Change in debt held by the public	296.7	426.7	372.6	241.9	226.0	201.4	225.1
Changes in Debt Subject to Limitation:							
Change in debt held by the public	296.7	426.7	372.6	241.9	226.0	201.4	225.1
Change in debt held by Government accounts	254.0	279.5	311.4	328.0	345.6	344.3	328.9
Change in other factors	–13.0	0.4	0.6	0.6	2.8	2.4	2.5
Total, change in debt subject to statutory limitation	537.7	706.5	684.5	570.5	574.4	548.1	556.5
Debt Subject to Statutory Limitation, End of Year:							
Debt issued by Treasury	7,879.2	8,585.7	9,270.2	9,840.7	10,413.0	10,959.4	11,514.2
Less: Treasury debt not subject to limitation(–) [3]	–14.5	–14.5	–14.5	–14.5	–12.4	–10.7	–8.9
Agency debt subject to limitation	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Adjustment for discount and premium [4]	6.3	6.3	6.3	6.3	6.3	6.3	6.3
Total, debt subject to statutory limitation [5]	7,871.0	8,577.6	9,262.1	9,832.5	10,406.9	10,955.1	11,511.6
Debt Outstanding, End of Year:							
Gross Federal debt: [6]							
Debt issued by Treasury	7,879.2	8,585.7	9,270.2	9,840.7	10,413.0	10,959.4	11,514.2
Debt issued by other agencies	26.2	25.8	25.2	24.7	24.0	23.2	22.5
Total, gross Federal debt	7,905.3	8,611.5	9,295.4	9,865.3	10,436.9	10,982.7	11,536.7
Held by:							
Debt held by Government accounts	3,313.1	3,592.6	3,904.0	4,231.9	4,577.5	4,921.8	5,250.8
Debt held by the public [7]	4,592.2	5,018.9	5,391.5	5,633.4	5,859.4	6,060.8	6,285.9

* $50 million or less.

[1] A decrease in the Treasury operating cash balance (which is an asset) is a means of financing a deficit and therefore has a positive sign. An increase in checks outstanding (which is a liability) is also a means of financing a deficit and therefore also has a positive sign.

[2] Besides checks outstanding, includes accrued interest payable on Treasury debt, uninvested deposit fund balances, allocations of special drawing rights, and other liability accounts; and, as an offset, cash and monetary assets (other than the Treasury operating cash balance), other asset accounts, and profit on sale of gold.

[3] Consists primarily of Federal Financing Bank debt.

[4] Consists mainly of unamortized discount (less premium) on public issues of Treasury notes and bonds (other than zero-coupon bonds) and unrealized discount on Government account series securities.

[5] The statutory debt limit is $8,184 billion, enacted on November 19, 2004.

[6] Treasury securities held by the public and zero-coupon bonds held by Government accounts are almost all measured at sales price plus amortized discount or less amortized premium. Agency debt securities are almost all measured at face value. Treasury securities in the Government account series are otherwise measured at face value less unrealized discount (if any).

[7] At the end of 2005, the Federal Reserve Banks held $736.4 billion of Federal securities and the rest of the public held $3,855.9 billion. Debt held by the Federal Reserve Banks is not estimated for future years.

from the public is therefore an important concern of Federal fiscal policy. [3]

Issuing debt securities to Government accounts performs an essential function in accounting for the operation of these funds. The balances of debt represent the cumulative surpluses of these funds due to the excess of their tax receipts, interest receipts, and other collections compared to their spending. The interest on the debt that is credited to these funds accounts for the fact that some earmarked taxes and user fees will be spent at a later time than when the funds receive the monies. The debt securities are a liability of the general fund to the fund that holds the securities and

[3] The Federal subsector of the national income and product accounts provides a measure of "net government saving" (based on current expenditures and current receipts) that can be used to analyze the effect of Federal fiscal policy on national saving within the framework of an integrated set of measures of aggregate U.S. economic activity. The Federal subsector and its differences from the budget are discussed in Chapter 14 of this volume, "National Income and Product Accounts."

are a mechanism for crediting interest to that fund on its recorded balances. These accounting balances generally provide the fund with authority to draw upon the U.S. Treasury in later years to make future payments on its behalf to the public. Public policy may run surpluses and accumulate debt in trust funds and other Government accounts in anticipation of future spending.

However, issuing debt to Government accounts does not have any of the economic effects of borrowing from the public. It is an internal transaction of the Government, made between two accounts that are both within the Government itself. It is not a current transaction of the Government with the public; it is not financed by private saving and does not compete with the private sector for available funds in the credit market; it does not provide the account with resources other than a legal claim on the U.S. Treasury, which itself obtains real resources by taxation and borrowing; and its current interest does not have to be financed by taxes or other means.

Furthermore, the debt held by Government accounts does not represent the estimated amount of the account's obligations or responsibilities to make future payments to the public. For example, if the account records the transactions of a social insurance program, the debt that it holds does not represent the actuarial present value of estimated future benefits (or future benefits less taxes) for the current participants in the program; nor does it represent the actuarial present value of estimated future benefits (or future benefits less taxes) for the current participants plus the estimated future participants over some stated time period. The future transactions of Federal social insurance and employee retirement programs, which own 91 percent of the debt held by Government accounts, are important in their own right and need to be analyzed separately. This can be done through information published in the actuarial and financial reports for these programs. [4]

This Budget uses a variety of information sources to analyze the condition of Social Security and Medicare, the Government's two largest social insurance programs. Chapter 13 of the present volume, "Stewardship," projects Social Security and Medicare outlays to 2080 relative to GDP. It also discusses in some detail the actuarial projections prepared for the Social Security and Medicare trustees reports to evaluate the long-run actuarial deficiency or shortfall in these programs. A chapter in the main volume of the Budget, "The Nation's Fiscal Outlook," uses the same data in less detail to explain the long-run fiscal problems of Social Security and Medicare revealed by these projections. The actuarial shortfalls are very different in concept and much larger in size than the amount of Treasury debt that these programs hold.

For all these reasons, debt held by the public is a better concept than gross Federal debt for analyzing the effect of the budget on the economy.

Debt securities do not encompass all the liabilities of the Federal Government. For example, accounts payable occur in the normal course of buying goods and services; Social Security benefits are due and payable as of the end of the month but, according to statute, are paid during the next month; loan guarantee liabilities are incurred when the Government guarantees the payment of interest and principal on private loans; and liabilities for future pension and retiree health payments are incurred as part of the current compensation for the services performed by Federal civilian and military employees in producing Government outputs. Like debt securities sold in the credit market, these liabilities have their own distinctive effects on the economy. Federal liabilities are analyzed within the broader conceptual framework of Federal resources and responsibilities in the "Stewardship" Chapter of this volume. The different types of liabilities are reported annually in the financial statements of Federal agencies and in the *Financial Report of the United States Government*, prepared by the Treasury Department.

Government Surpluses or Deficits and the Change in Debt

Table 16–2 summarizes Federal borrowing and debt from 2005 through 2011. In 2005 the Government borrowed $297 billion, so the debt held by the public increased to $4,592 billion. The debt held by Government accounts increased $254 billion, and gross Federal debt increased by $551 billion to $7,905 billion.

Debt held by the public. The Federal Government primarily finances deficits by borrowing from the public, and it primarily uses surpluses to repay debt held by the public. Table 16–2 shows the relationship between the Federal deficit or surplus and the change in debt held by the public. The borrowing or debt repayment depends on the Federal Government's expenditure programs and tax laws, on the economic conditions that influence tax receipts and outlays, and on debt management policy. The sensitivity of the budget to economic conditions is analyzed in Chapter 12 of this volume, "Economic Assumptions."

The total or unified budget surplus consists of two parts: the on-budget surplus or deficit; and the surplus of the off-budget Federal entities, which have been excluded from the budget by law. Under present law, the off-budget Federal entities are the Social Security trust funds (Old-Age and Survivors Insurance and Disability Insurance) and the Postal Service fund. [5] The off-budget totals are virtually the same as Social Security, which had a large surplus in 2005 and is estimated to have large surpluses throughout the projection period. The on-budget and off-budget surpluses or deficits are added together to determine the Government's financing needs.

[4] Extensive actuarial analyses of the Social Security and Medicare programs are published in the annual reports of the boards of trustees of these funds. Annual actuarial reports are also prepared for major Federal employee retirement funds. The actuarial estimates for these and other programs are summarized in the *Financial Report of the United States Government*, prepared annually by the Treasury Department.

[5] For further explanation of the off-budget Federal entities, see Chapter 23 of this volume, "Off-Budget Federal Entities and Non-Budgetary Activities."

The Government's need to borrow, or its ability to repay debt held by the public, has always depended on several other factors besides the unified budget surplus or deficit, such as the change in the Treasury operating cash balance. As shown in Table 16–2, these other factors, which in this table are called "financing other than the change in debt held by the public," can either increase or decrease the Government's need to borrow. (An increase in its need to borrow is represented by a negative sign, like the deficit.) Some of these individual factors themselves may be either positive or negative, and some of them vary considerably in size from year to year. In 2005 the deficit was $318 billion and the "financing other than the change in debt held by the public" was $22 billion. As a result, the Government borrowed $297 billion from the public.

Over the long-run, it is a good approximation to say that "the deficit is financed by borrowing from the public" or "the surplus is used to repay debt held by the public." Over the last 20 years, the cumulative deficit was $2,918 billion and the increase in debt held by the public was $3,085 billion. Thus, the other factors added a total of $167 billion of borrowing, an average of $8 billion per year.

In individual years it is also often a good approximation to say that the deficit and borrowing (or the surplus and debt repayment) are about the same. The variation, however, can be wide, ranging over the last 20 years from additional borrowing (or lower repayment) of $63 billion in 2002 to reduced borrowing of $30 billion in 2004. The other factors are estimated to increase borrowing in each of the years from 2006 through 2011, by amounts ranging from $4 billion in 2006 to $20 billion in 2011. Three specific factors presented in Table 16–2 have recently been especially important.

Change in Treasury operating cash balance.—The operating cash balance decreased $26 billion during 2003, partly because it was higher than planned at the end of the previous year. Since then, however, changes in the operating cash balance have been much smaller, with a $1 billion increase in 2004 and a $1 billion decrease in 2005. The operating cash balance is estimated to again be essentially the same at the end of 2006. Changes in the operating cash balance, while occasionally large, are inherently limited. Decreases in cash—a means of financing the Government—are limited by the amount of past accumulations, which themselves required financing when they were built up. Increases are limited because it is more efficient to repay debt.

Net purchases of non-Federal securities by the National Railroad Retirement Investment Trust.—This trust fund was established by the Railroad Retirement and Survivors' Improvement Act of 2001. Most of the assets in the Railroad Retirement Board trust funds were transferred to the new trust fund in 2003, which invests its assets primarily in private stocks and bonds. The Act ordered special treatment of the purchase or sale of non-Federal assets by this trust fund, treating such purchases as a means of financing rather than an outlay. Therefore, the increased need to borrow from the public to finance the purchase of non-Federal assets is part of the "financing other than the change in debt held by the public" rather than included as an increase in the deficit. This increased borrowing and publicly held debt by $20 billion in 2003. Net purchases were relatively small in 2004 and 2005 and are estimated to remain relatively small in future years.[6]

Net financing disbursements of the direct loan and guaranteed loan financing accounts.—The financing accounts were created by the Federal Credit Reform Act of 1990. Under this Act, budget outlays for direct loans and loan guarantees consist of the estimated subsidy cost of the loans or guarantees at the time when the direct loans or guaranteed loans are disbursed. The cash flows to and from the public resulting from these loans and guarantees—the disbursement and repayment of loans, the default payments on loan guarantees, the collections of interest and fees, and so forth—are not costs to the Government except for those costs already included in budget outlays. Therefore, they are non-budgetary in nature and are recorded as transactions of the non-budgetary financing account for each credit program.[7]

The financing accounts also include several types of intra-governmental transactions. In particular, they receive payment from the credit program accounts for the costs of new direct loans and loan guarantees; they also receive payment for any upward reestimate of the costs of direct loans and loan guarantees outstanding. These collections are offset against the gross disbursements of the financing accounts in determining the accounts' total net cash flows. The total net cash flows of the financing accounts, consisting of transactions with both the public and the budgetary accounts, are called "net financing disbursements." They are defined in the same way as the "outlays" of a budgetary account and therefore affect the requirement for borrowing from the public in the same way as the deficit.

The result is that the intragovernmental transactions of the financing accounts do not affect Federal borrowing from the public. Although the deficit changes because of the budget's outlay to, or receipt from, a financing account, the net financing disbursement changes in an equal amount with the opposite sign, so the effects cancel out. On the other hand, financing account disbursements to the public increase the requirement for borrowing from the public in the same way as an increase in budget outlays that are disbursed to the public in cash. Likewise, financing account receipts from the public can be used to finance the payment of the Government's obligations, and therefore they reduce the requirement for Federal borrowing from

[6] The budget treatment of this fund is further discussed in Chapter 26 of this volume, "The Budget System and Concepts."

[7] The Federal Credit Reform Act of 1990 (sec. 505(b)) requires that the financing accounts be non-budgetary. As explained in Chapter 23 of this volume, "Off-Budget Federal Entities and Non-Budgetary Activities," they are non-budgetary in concept because they do not measure cost. For additional discussion of credit reform, see Chapter 26 of this volume, "The Budget System and Concepts," and the other references cited in Chapter 23 of this volume.

the public in the same way as an increase in budget receipts.

The impact of the financing accounts became large in the mid-1990s. In 2004 and 2005, large upward reestimates were made in the cost of outstanding direct and guaranteed loans. The credit program accounts in the budget made large outlays to the financing accounts, which in turn had equal offsetting collections and therefore large negative net financing disbursements. The result is shown as a positive amount in Table 16–2, canceling out the effect of a higher budget deficit on the Government's borrowing requirement. Large upward reestimates are also estimated for 2006, after which the pattern is expected to be more normal. The financing accounts are estimated to increase the need for borrowing by $5 billion in 2006 and from $19 billion to $22 billion in each of the following five years. A major part of this financing is normally due to the direct student loan program. Since direct loans require cash disbursements equal to the full amount of the loans when the loans are made, Federal borrowing requirements are initially increased. Later, when the loans are repaid, Federal borrowing requirements will decrease.

In addition, prior to 2005, the *change in compensating balances* was an important factor. Treasury used compensating balances—deposits of non-interest bearing balances—to compensate banks for collecting tax and non-tax receipts and providing other services. The imputed earnings from the compensating balances, calculated at the 91-day Treasury bill rate, were the source of the bank's compensation for performing the required services. Banks could use the compensating balances on deposit to make loans or buy investments, and all compensating balances were fully collateralized. However, the compensating balances presented difficulties for cash and debt management. First, changes in the applied interest rate required Treasury to change the size of compensating balances on deposit to pay for the services it needed. Second, when the debt outstanding reached the statutory debt limit, Treasury had to draw down the compensating balances and then make up for this action afterwards by increasing the balances to unusually high levels. These actions were inefficient and disruptive, and they created financial uncertainty for Treasury and the banks.

In large part because of these difficulties, the 2004 Budget proposed legislation to replace compensating balances by a permanent indefinite appropriation to pay banks directly for their services as depositaries and financial agents. Congress included a permanent indefinite appropriation in the Consolidated Appropriation Act of 2004 (P.L. 108–199), and compensating balances were drawn down to zero during 2004.

Debt held by Government accounts.—The amount of Federal debt issued to Government accounts depends largely on the surpluses of the trust funds, both on-budget and off-budget, which owned 94 percent of the total Federal debt held by Government accounts at the end of 2005. In 2005, the total trust fund surplus was $237 billion, and trust funds invested $226 billion in Federal securities. Investment may differ somewhat from the surplus due to changes in the amount of cash assets not currently invested. The remainder of debt issued to Government accounts is owned by a number of special funds and revolving funds. The debt held in major accounts and the annual investments are shown in Table 16–4.

Agency Debt

Several Federal agencies, shown in Table 16–3, sell debt securities to the public and at times in the past have sold securities to other Government accounts. During 2005, agencies repaid $0.7 billion of debt held by the public, resulting in total agency debt of $26.2 billion as of the end of the year. Agency debt is less than one percent of Federal debt held by the public. Agencies are estimated to repay small amounts of debt in 2006 and 2007.

The reasons for issuing agency debt differ considerably from one agency to another. The predominant agency borrower is the Tennessee Valley Authority, which had borrowed $26 billion from the public as of the end of 2005, or 98 percent of the total debt of all agencies. (In some earlier periods, other agencies accounted for a much higher proportion of agency debt than they do now.) TVA sells debt primarily to finance capital expenditures.

The Federal Housing Administration, on the other hand, has for many years issued both checks and debentures as means of paying claims to the public that arise from defaults on FHA-insured mortgages. This borrowing is thus inherent in the way that the FHA program operates. Issuing debentures to pay the Government's bills is equivalent to selling securities to the public and then paying the bills by disbursing the cash borrowed, so the transaction is recorded as being simultaneously an outlay and a borrowing. The debentures are therefore classified as agency debt.

Some types of lease-purchase contracts are equivalent to direct Federal construction financed by Federal borrowing. A number of years ago, the Federal Government guaranteed the debt used to finance the construction of buildings for the National Archives and the Architect of the Capitol, and subsequently exercised full control over the design, construction, and operation of the buildings. The construction expenditures and interest were therefore classified as Federal outlays, and the borrowing was classified as Federal agency borrowing from the public.

Under current budgetary treatment, outlays for a lease-purchase without substantial private risk are recorded in an amount equal to the asset cost over the period during which the contractor constructs, manufactures, or purchases the asset; if the asset already exists, the outlays are recorded when the contract is signed. Agency borrowing is recorded each year to the extent of these outlays. The agency debt is subsequently redeemed over the lease payment period by a portion

Table 16–3. AGENCY DEBT

(In millions of dollars)

	Borrowing or repayment (–) of debt			Debt end of 2007 estimate
	2005 actual	2006 estimate	2007 estimate	
Borrowing from the public:				
Housing and Urban Development:				
Federal Housing Administration	–54	*	....	146
Small Business Administration:				
Participation certificates: Section 505 development company	....	–*	–7	....
Architect of the Capitol	–3	–4	–4	152
Farm Credit System Financial Assistance Corporation	–325	....	....	....
National Archives	–8	–9	–10	215
Tennessee Valley Authority:				
Bonds and Notes	–156	–208	–387	22,501
Lease/leaseback obligations	–35	–33	–39	1,071
Prepayment obligations	–105	–106	–105	1,155
Total, borrowing from the public	–686	–360	–552	25,241
Borrowing from other funds:				
Tennessee Valley Authority	....	....	....	1
Total, borrowing from other funds	....	....	....	1
Total, agency borrowing	–686	–360	–552	25,242

* $500,000 or less.

of the annual lease payments according to an amortization schedule.[8]

The Tennessee Valley Authority has traditionally financed its capital construction by selling bonds and notes to the public. Starting in 2000, it has also employed two types of alternative financing methods. The first type of alternative financing method was lease/leasebacks. TVA signed contracts to lease some recently constructed power generators to private investors and simultaneously lease them back. It received a lump sum for leasing out its assets, and then leased them back at fixed annual payments for a set number of years. TVA retains substantially all of the economic benefits and risks related to ownership of the assets, and the lease/leasebacks are reported as liabilities on TVA's balance sheet under generally accepted accounting principles.

The Office of Management and Budget determined that the TVA lease/leasebacks are a means of financing the acquisition of assets owned and used by the Government. The arrangement is at least as governmental as a "lease-purchase without substantial private risk." The budget therefore records the upfront cash proceeds from the lease as borrowing from the public, not offsetting collections. Agency debt in the form of a lease obligation is recorded as a type of borrowing. The same budget treatment was applied to the lease/leaseback of qualified technological equipment in 2003. The total amount of the lease obligations beginning in 2000 is shown in Table 16–3 separately from TVA bonds and notes to distinguish between the types of borrowing. The obligations for lease/leasebacks were $1.1 billion at the end of 2005 and are estimated to decline steadily in the following years as they are amortized.

The second type of alternative financing method is prepayments for power that TVA sells to its power distributors. Under the Discounted Energy Units program, which began in 2003, distributors may prepay a portion of the price of the power they plan to purchase in the future. In return, they obtain a discount on a specific quantity of the future power they buy from TVA. The quantity varies, depending on TVA's estimated cost of borrowing. Most of the prepayments have been relatively small. However, TVA also entered into a contract with Memphis Light, Gas, and Water (MLGW), under which that distributor prepaid $1.5 billion in 2004 for a large portion of its power needs over the next 15 years in return for a discount on that power. MLGW, in turn, financed its prepayment by selling tax-exempt bonds.

The Office of Management and Budget determined that these prepayments are also a means of financing the acquisition of assets owned and used by the Federal Government, or, in effect, are used to refinance debt previously incurred to finance such assets. They are equivalent in concept to other forms of borrowing from the public, although at different terms and conditions. The prepayment obligations are recorded as liabilities, called "unearned revenue," on TVA's balance sheet under generally accepted accounting principles. The budget therefore records the upfront cash proceeds from the prepayment as borrowing from the public, not off-

[8] This rule of budgetary treatment became effective in 1991. The rule addressed all lease-purchases and capital leases from the public, not just those without substantial private risk. For all such contracts, the rule requires that budget authority be recorded up front for the present value of the lease payments. This budgetary treatment was reviewed in connection with the Balanced Budget Act of 1997. Some clarifications were made, but no substantive changes. See OMB Circular No. A–11, Appendix B. Also see the section on outlays in Chapter 26 of this volume, "The Budget System and Concepts."

setting collections. Agency debt in the form of a prepayment obligation is recorded as a type of borrowing. The total amount of prepayment obligations is shown in Table 16–3 separately from bonds and notes and lease/leaseback obligations to distinguish among the types of borrowing. The prepayment obligations increased from zero to $47 million during 2003 and to $1,471 billion at the end of 2004 because of the contract with Memphis Light, Gas, and Water. The obligations declined by $0.1 billion in 2005 and are estimated to continue to decline steadily in the following years as TVA provides electric power under the contracts.

The amount of agency securities sold to the public has been reduced by borrowing from the Federal Financing Bank (FFB). The FFB is an entity within the Treasury Department, one of whose purposes is to substitute Treasury borrowing for agency borrowing from the public. It has the authority to purchase agency debt and finance these purchases by borrowing from the Treasury. Agency borrowing from the FFB is not included in gross Federal debt. It would be double counting to add together (a) the agency borrowing from the FFB and (b) the Treasury borrowing from the public that was needed to provide the FFB with the funds to lend to the agencies.

Debt Held by Government Accounts

Trust funds, and some special funds and public enterprise revolving funds, accumulate cash in excess of current needs in order to meet future obligations. These cash surpluses are generally invested in Treasury debt.

Investment by trust funds and other Government accounts has risen greatly for many years. It was $254 billion in 2005, as shown in Table 16–4, and is estimated to rise to $311 billion in 2007. The holdings of Federal securities by Government accounts are estimated to grow to $3,904 billion by the end of 2007, or 42 percent of the gross Federal debt. The percentage is estimated to rise gradually in the following years, as the trust funds and several major revolving funds and special funds continue to accumulate surpluses.

The large investment by Government accounts is concentrated among a few trust funds. The two Social Security trust funds—Old-Age and Survivors Insurance and Disability Insurance—have a large combined surplus and invest $546 billion during 2005–07, which is 65 percent of the total estimated investment by Government accounts. The funds for Federal employee retirement also invest a large share of the total. The principal trust fund for Federal civilian employees is the civil service retirement and disability trust fund, which accounts for 11 percent of the total investment by Government accounts during 2005–07. The military retirement trust fund and the special fund for uniformed services retiree health care account for another 13 percent. The two Medicare trust funds—Hospital Insurance and Supplementary Medical Insurance—account for another 9 percent. Altogether, the investment by Social Security, Medicare, and these three Federal employee retirement funds is almost as much as the total investment by Government accounts during this period. At the end of 2007, they are estimated to own 92 percent of the total debt held by Government accounts. Many of the other Government accounts also increase their holdings of Federal securities during this period.

Technical note on measurement.—The Treasury securities held by Government accounts consist almost entirely of the Government account series. Most were issued at par value (face value), and the securities issued at a discount or premium were traditionally recorded at par in the OMB and Treasury reports on Federal debt. However, there are two kinds of exceptions. First, in 1991, Treasury began to issue zero-coupon bonds to a very few Government accounts. Because the purchase price is a small fraction of par value and the amounts are large, the holdings are recorded in Table 16–4 at par value less unamortized discount. The only two Government accounts that held zero-coupon bonds during the period of this table are the Nuclear Waste Disposal fund in the Department of Energy and the Pension Benefit Guaranty Corporation (PBGC). The total unamortized discount on zero-coupon bonds was $16.5 billion at the end of 2005.

Second, in September 1993 Treasury began to subtract the unrealized discount on other Government account series securities in calculating "net federal securities held as investments of government accounts." Unlike the discount recorded for zero-coupon bonds and debt held by the public, the unrealized discount is the discount at the time of issue and is not amortized over the term of the security. In Table 16–4 it is shown as a separate item at the end of the table and not distributed by account. The amount was $1.6 billion at the end of 2005.

Limitations on Federal Debt

Definition of debt subject to limit.—Statutory limitations have usually been placed on Federal debt. Until World War I, the Congress ordinarily authorized a specific amount of debt for each separate issue. Beginning with the Second Liberty Bond Act of 1917, however, the nature of the limitation was modified in several steps until it developed into a ceiling on the total amount of most Federal debt outstanding. This last type of limitation has been in effect since 1941. The limit currently applies to most debt issued by the Treasury since September 1917, whether held by the public or by Government accounts; and other debt issued by Federal agencies that, according to explicit statute, is guaranteed as to principal and interest by the United States Government.

The third part of Table 16–2 compares total Treasury debt with the amount of Federal debt that is subject to the limit. Nearly all Treasury debt is subject to the debt limit. Most of the Treasury debt not subject to the general statutory limit was issued by the Federal Financing Bank (FFB). The FFB, which is within the Treasury Department, is authorized to have outstanding up to $15 billion of publicly issued debt. It issued $14 billion of securities to the Civil Service Retirement and Disability fund on November 15, 2004, in exchange for an equal amount of regular Treasury securities, as explained below in the section on changes in the debt limit. The FFB securities have the same interest rates and maturities as the regular Treasury securities for which they were exchanged. The securities mature on dates from June 30, 2009 through June 30, 2019. The securities are assumed to remain outstanding until they mature. The other Treasury debt not subject to the general limit consists almost entirely of silver certificates and other currencies no longer being issued. It was $509 million at the end of 2005 and gradually declines over time.

The sole agency debt currently subject to the general limit, $130 million at the end of 2005, is certain debentures issued by the Federal Housing Administration.[9] Some of the other agency debt, however, is subject to its own statutory limit. For example, the Tennessee Valley Authority is limited to $30 billion of bonds and notes outstanding.

The comparison between Treasury debt and debt subject to limit also includes an adjustment for measurement differences in the treatment of discounts and premiums. As explained earlier in this Chapter, debt securities may be sold at a discount or premium, and the measurement of debt may take this into account rather than recording the face value of the securities. However, the measurement differs between gross Federal debt (and its components) and the statutory definition of debt subject to limit. An adjustment is needed to derive debt subject to limit (as defined by law) from Treasury debt. The amount is relatively small: $6.3 billion at the end of 2005 compared to the total unamortized discount (less premium) of $53.5 billion on all Treasury securities.

Table 16–4. DEBT HELD BY GOVERNMENT ACCOUNTS[1]

(In millions of dollars)

Description	Investment or Disinvestment (–)			Holdings end of 2007 estimate
	2005 actual	2006 estimate	2007 estimate	
Investment in Treasury debt:				
Energy:				
Nuclear waste disposal fund[1]	1,592	804	845	19,327
Uranium enrichment decontamination fund	234	298	301	4,490
Health and Human Services:				
Federal hospital insurance trust fund	12,892	18,386	20,579	316,233
Federal supplementary medical insurance trust fund	–235	11,430	9,514	38,148
Vaccine injury compensation fund	151	197	199	2,561
Housing and Urban Development:				
Federal Housing Administration mutual mortgage fund	–678	465	....	23,107
Other HUD	387	320	330	8,603
Interior: Abandoned mine reclamation fund	90	140	170	2,445
Labor:				
Unemployment trust fund	9,567	–8,740	13,610	59,676
Pension Benefit Guaranty Corporation[1]	–111	–807	–113	11,448
State: Foreign service retirement and disability trust fund	532	20	20	13,399
Transportation:				
Highway trust fund	–1,941	2,358	–1,120	9,509
Airport and airway trust fund	156	–980	–151	8,916
Homeland Security:				
Oil spill liability trust fund	–98	–134	–11	587
Aquatic resources trust fund	99	–445	198	1,301
Treasury: Exchange stabilization fund	4,919	214	....	15,452
Veterans Affairs:				
National service life insurance trust fund	–351	–423	–484	9,690
Other trust funds	32	16	10	2,063
Federal funds	–24	–28	–31	390
Other Defense-Civil:				
Uniformed services retiree health care fund	17,009	30,288	32,324	115,485
Military retirement trust fund	1	16,856	9,146	203,284
Harbor maintenance trust fund	384	–788	....	1,833
Environmental Protection Agency:				
Hazardous substance trust fund	98	19	....	2,344
Leaking underground storage tank trust fund	204	–1	....	2,436
International Assistance Programs:				
Overseas Private Investment Corporation	234	135	136	4,300
Office of Personnel Management:				
Civil service retirement and disability trust fund	28,890	30,004	30,465	721,219

[9] At the end of 2005, $16 million of FHA debentures was not subject to limit.

Table 16–4. DEBT HELD BY GOVERNMENT ACCOUNTS [1]—Continued

(In millions of dollars)

Description	Investment or Disinvestment (–) 2005 actual	2006 estimate	2007 estimate	Holdings end of 2007 estimate
Employees life insurance fund	1,378	1,452	1,642	32,579
Employees health benefits fund	1,759	1,548	1,053	15,134
Social Security Administration:				
Federal old-age and survivors insurance trust fund [2]	163,560	171,664	185,852	1,973,675
Federal disability insurance trust fund [2]	10,464	8,251	6,558	208,072
Farm Credit System Insurance Corporation:				
Farm Credit System Insurance fund	–77	–14	....	1,924
Federal Deposit Insurance Corporation:				
Bank insurance fund	644	–32,733	....	....
FSLIC resolution fund	110	187	....	3,310
Savings association insurance fund	473	–12,325	....	....
Deposit insurance fund	....	46,219	....	46,219
National Credit Union Administration: Share insurance fund	364	344	386	7,153
Postal Service fund [2]	–65	*	....	1,218
Railroad Retirement Board trust funds [1]	236	439	10	2,449
Other Federal funds [3]	2,827	–5,120	–165	10,934
Other trust funds	–1,561	–52	127	4,682
Unrealized discount [1]	–168	....	....	–1,645
Total, investment in Treasury debt [1]	**253,974**	**279,463**	**311,400**	**3,903,950**
Investment in agency debt:				
Railroad Retirement Board:				
National Railroad Retirement Investment Trust	....	....	....	1
Total, investment in agency debt [1]	....	....	....	**1**
Total, investment in Federal debt [1]	**253,974**	**279,463**	**311,400**	**3,903,951**
MEMORANDUM				
Investment by Federal funds (on-budget)	27,991	28,386	34,183	274,587
Investment by Federal funds (off-budget)	–65	*	....	1,218
Investment by trust funds (on-budget)	52,192	71,162	84,807	1,448,044
Investment by trust funds (off-budget)	174,024	179,915	192,410	2,181,747
Unrealized discount [1]	–168	....	....	–1,645

* $500 thousand or less.

[1] Debt held by Government accounts is measured at face value except for the Treasury zero-coupon bonds held by the Nuclear waste disposal fund and the Pension Benefit Guaranty Corporation (PBGC), which are recorded at market or redemption price; and the unrealized discount on Government account series, which is not distributed by account. Changes are not estimated in the unrealized discount. If recorded at face value, the debt held by the Nuclear waste disposal fund would be $15.9 billion higher than recorded in this table at the end of 2005; the debt held by PBGC would be $0.7 billion higher.

[2] Off-budget Federal entity.

[3] Includes a $16 million decrease to the debt held by the National Archives and Records Administration at the end of 2004.

Changes in the debt limit.—The statutory debt limit has been changed many times. Since 1960, Congress has passed 71 separate acts to raise the limit, extend the duration of a temporary increase, or revise the definition. For a long period up to 1990, the debt limit was also changed frequently. During the 1990s, however, the debt limit was increased three times by amounts large enough to last for two years or more. All three of these increases were enacted as part of a deficit reduction package or a plan to balance the budget and were intended to last a relatively long time: the Omnibus Budget Reconciliation Act of 1990, the Omnibus Budget Reconciliation Act of 1993, and the Balanced Budget Act of 1997. [10]

[10] The Acts and the statutory limits since 1940 are listed in *Historical Tables, Budget of the United States Government*, *Fiscal Year 2007*, Table 7.3.

The Balanced Budget Act of 1997 increased the debt limit to $5,950 billion, which lasted until 2002. When the debt reached the limit in April 2002, the Treasury Department took a variety of administrative actions to keep within the limit, and on June 28 the President signed a bill to raise the limit to $6,400 billion. This process was repeated within less than one year. The debt reached the limit in February 2003, so the Treasury Department again responded with various administrative actions, and on May 27, 2003, the President signed a bill that raised the limit to $7,384 billion.

This limit did not last much longer than the previous limit. By August 2004, the Secretary of Treasury wrote Congress that the debt subject to limit might reach the ceiling in September or October 2004. It did reach the limit on October 14 and stayed there until the limit was increased.

Treasury took a number of administrative steps during this period to meet the Government's obligation to pay its bills and invest its trust funds while keeping debt under the statutory limit. On October 14, 2004, the Secretary of Treasury declared that he would not be able to fully invest the Government Securities Investment Fund (G-fund) as of that day. This fund is one component of the Thrift Savings Fund, a defined contribution pension plan for Federal employees. The Secretary has statutory authority to suspend investment of the G-fund in Treasury securities as needed to prevent the debt from exceeding the debt limit. When he does this, he is required to make the fund whole after the debt limit has been raised by restoring the forgone interest and investing the fund fully. Starting on October 14, Treasury determined each day the amount of investments that would allow the fund to be invested as fully as possible without exceeding the debt limit. That amount was invested, and no more. The balances not invested varied throughout the period. In addition to this step, Treasury discontinued the acceptance of subscriptions to the State and local government series of securities.

As the need for financing grew, Treasury took further steps. On November 15, 2004, the Federal Financing Bank (FFB) issued $14 billion of FFB securities to the Civil Service Retirement and Disability fund in exchange for an equal amount of regular Treasury securities, which FFB then exchanged with Treasury at market value in return for the extinguishment of an equal market value of FFB debt owed to Treasury. The FFB securities are not subject to the debt limit, as explained above, whereas the regular Treasury securities are subject to the limit. The Secretary also declared a debt issuance suspension period from November 17 to December 2. This allowed him to redeem a limited amount of securities held by the Civil Service Retirement and Disability fund and stop investing its receipts. Treasury disinvested part of the Exchange Stabilization fund for one day. Treasury also delayed the announcement of auctions of marketable securities.

All the steps taken during October and November had also been taken on previous occasions when the debt had reached the statutory limit, including in 2002 or 2003. When the debt limit was reached in those years, Treasury also reduced its compensating balances held in banks to pay for services under financial agency agreements. However, compensating balances were discontinued in 2004, as explained in a previous section.

Table 16–5. FEDERAL FUNDS FINANCING AND CHANGE IN DEBT SUBJECT TO STATUTORY LIMIT

(In billions of dollars)

Description	Actual 2005	Estimate 2006	2007	2008	2009	2010	2011
Federal funds deficit (–)	–555.1	–688.9	–620.4	–517.7	–516.9	–487.2	–490.5
Means of financing other than borrowing:							
Change in: [1]							
Treasury operating cash balances	0.7	....	....	....	....	....	....
Other [2]	25.0	14.9	–11.0	*	0.1	0.2	0.6
Seignorage on coins	0.7	0.7	0.7	0.7	0.7	0.7	0.7
Less: Net financing disbursements:							
Direct loan financing accounts	–4.9	–16.1	–18.3	–18.8	–19.2	–19.4	–21.0
Guaranteed loan financing accounts	10.7	11.6	–0.8	–0.5	–0.1	–0.2	–0.5
Total, means of financing other than borrowing	32.2	11.1	–29.4	–18.6	–18.5	–18.7	–20.2
Decrease or increase (–) in Federal debt held by Federal funds	–27.9	–28.4	–34.2	–33.6	–36.2	–39.8	–43.4
Increase or decrease (–) in Federal debt not subject to limit	13.4	–0.4	–0.6	–0.6	–2.8	–2.4	–2.5
Total, requirement for Federal funds borrowing subject to debt limit	537.5	706.5	684.5	570.5	574.4	548.1	556.5
Change in adjustment for discount and premium [3]	0.4	....	....	....	....	....	....
Change in unrealized discount [4]	–0.2	....	....	....	....	....	....
Increase in debt subject to limit	537.7	706.5	684.5	570.5	574.4	548.1	556.5
ADDENDUM							
Debt subject to statutory limit [5]	7,871.0	8,577.6	9,262.1	9,832.5	10,406.9	10,955.1	11,511.6

* $50 million or less.

[1] A decrease in the Treasury operating cash balance (which is an asset) is a means of financing the deficit and therefore has a positive sign. An increase in checks outstanding (which is a liability) is also a means of financing the deficit and therefore also has a positive sign.

[2] Includes Federal fund transactions that correspond to those defined in table 16–2, footnote 2, but that are for Federal funds alone with respect to the public and trust funds.

[3] Consists of unamortized discount (less premium) on public issues of Treasury notes and bonds (other than zero-coupon bonds) and unrealized discount on Government account series securities.

[4] The unrealized discount is for Government account series securities.

[5] The statutory debt limit is $8,184 billion, enacted on November 19, 2004.

These Treasury actions were used for a little more than one month. Congress passed a bill raising the debt limit to $8,184 billion on November 18, and the President signed the bill on November 19. Treasury promptly invested the G-fund and Civil Service Retirement and Disability fund fully and restored the forgone interest as prescribed by law. The securities whose auctions were postponed were issued on time, except for one issue of 4-week bills that was delayed a few days, and subscriptions to the State and local government series were accepted again.

On December 29, 2005, the Secretary of Treasury sent the Congress a letter stating that the statutory debt limit enacted in November 2004 would be reached in mid-February 2006. The letter stated that even if Treasury took steps such as those used previously once the Government reached the debt limit, Treasury could not continue to finance Government operations past mid-March.

Methods of changing the debt limit.—The statutory limit is usually changed by normal legislative procedures. Under the rules adopted by the House of Representatives, it can also be changed as a consequence of the annual Congressional budget resolution, which is not itself a law. The budget resolution includes a provision specifying the appropriate level of the debt subject to limit at the end of each fiscal year. The rule provides that, when the budget resolution is adopted by both Houses of the Congress, the vote in the House of Representatives is deemed to have been a vote in favor of a Joint Resolution setting the statutory limit at the level specified in the budget resolution. The Joint Resolution is transmitted to the Senate for further action, where it may be amended to change the debt limit provision or in any other way. If it passes both Houses of the Congress, it is sent to the President for his signature.

The House of Representatives first adopted this rule for 1980, although it was not included in the rules for several years before 2003. By virtue of adopting the Congressional budget resolution for 2005, the House was deemed to have voted in favor of raising the debt limit to a level of $8,965 billion. The Senate had not taken action on this limit as of the writing of this Budget.

Federal funds financing and the change in debt subject to limit.—The change in debt held by the public, as shown in Table 16–2, is determined primarily by the total Government deficit or surplus. The debt subject to limit, however, includes not only debt held by the public but also debt held by Government accounts. The change in debt subject to limit is therefore determined both by the factors that determine the total Government deficit or surplus and by the factors that determine the change in debt held by Government accounts. The effect of debt held by Government accounts on the total debt subject to limit is brought out sharply in the second part of Table 16–2. The change in debt held by Government accounts is a large proportion of the change in total debt subject to limit each year and accounts for half of the estimated total increase from 2006 through 2011.

The budget is composed of two groups of funds, Federal funds and trust funds. The Federal funds, in the main, are derived from tax receipts and borrowing and are used for the general purposes of the Government. The trust funds, on the other hand, are financed by taxes or other receipts earmarked by law for specified purposes, such as paying Social Security benefits or making grants to state governments for highway construction. [11]

A Federal funds deficit must generally be financed by borrowing, which can be done either by selling securities to the public or by issuing securities to Government accounts that are not within the Federal funds group. Federal funds borrowing consists almost entirely of Treasury securities that are subject to the statutory debt limit. Very little debt subject to statutory limit has been issued for reasons except to finance the Federal funds deficit. The change in debt subject to limit is therefore determined primarily by the Federal funds deficit, which is equal to the difference between the total Government surplus and the trust fund surplus. Trust fund surpluses are almost entirely invested in securities subject to the debt limit, and trust funds hold most of the debt held by Government accounts.

Table 16–5 derives the change in debt subject to limit. In 2005 the Federal funds deficit was $555 billion, and other factors reduced the requirement to borrow subject to limit by $18 billion. The net financing disbursements of the guaranteed loan financing accounts reduced the financing requirements by $11 billion, as explained in an earlier section. As an offset, special funds and revolving funds, which are part of the Federal funds group, invested $28 billion in Treasury securities. The largest single investment was $17 billion for the uniformed services retiree health care fund. As a net result of all these factors, debt subject to limit increased by $538 billion, while debt held by the public increased by $297 billion.

The debt subject to limit is estimated to increase to $8,578 billion by the end of 2006, which exceeds the present statutory debt limit of $8,184 billion. This is caused by a rise in the Federal funds deficit, supplemented by the other factors shown in Table 16–5. As a result, while debt held by the public increases by $1,694 billion from the end of 2005 through 2011, debt subject to limit increases by $3,641 billion.

[11] For further discussion of the trust funds and Federal funds groups, see Chapter 22 of this volume, "Trust Funds and Federal Funds."

Debt Held by Foreign Residents

During most of American history, the Federal debt was held almost entirely by individuals and institutions within the United States. In the late 1960s, as shown in Table 16–6, foreign holdings were just over $10 billion, less than 5 percent of the total Federal debt held by the public.

Foreign holdings began to grow significantly starting in 1970. This increase has been almost entirely due to decisions by foreign central banks, corporations, and individuals, rather than the direct marketing of these securities to foreign residents. At the end of 2005 foreign holdings of Treasury debt were $2,070 billion, which was 45 percent of the total debt held by the public.[12] Foreign central banks owned 63 percent of the Federal debt held by foreign residents; private investors owned nearly all the rest. The percentage held by foreign central banks is down slightly from 64 percent at the end of 2004. All the Federal debt held by foreign residents is denominated in dollars.

Although the amount of Federal debt held by foreign residents has grown greatly over this period, the proportion that foreign residents own, after increasing abruptly in the very early 1970s, remained about 15–20 percent until the mid-1990s. During 1995–97, however, foreign holdings increased on average by around $200 billion each year, considerably more than total Federal borrowing from the public.[13] As a result, the Federal debt held by individuals and institutions within the United States decreased in absolute amount during those years, despite further Federal borrowing, and the percentage of Federal debt held by foreign residents grew from 19 percent at the end of 1994 to 32 percent at the end of 1997. In the next few years the change in foreign debt holdings was much smaller. However, the Federal debt held by foreign residents increased by $253 billion in 2003, $382 billion in 2004, and $233 billion in 2005. The percentage of Federal debt held by foreign residents increased from 34 percent to 45 percent during these three years. The increase in foreign holdings was slightly greater than the total Federal borrowing from the public in 2004 and about 80 percent of total Federal borrowing in 2005.

Table 16–6. FOREIGN HOLDINGS OF FEDERAL DEBT

(Dollar amounts in billions)

Fiscal Year	Debt held by the public			Borrowing from the public	
	Total	Foreign [1]	Percentage foreign	Total [2]	Foreign [1]
1965	260.8	12.3	4.7	3.9	0.3
1966	263.7	11.6	4.4	2.9	–0.7
1967	266.6	11.4	4.3	2.9	–0.2
1968	289.5	10.7	3.7	22.9	–0.7
1969	278.1	10.3	3.7	–11.4	–0.4
1970	283.2	14.0	5.0	5.1	3.8
1971	303.0	31.8	10.5	19.8	17.8
1972	322.4	49.2	15.2	19.3	17.3
1973	340.9	59.4	17.4	18.5	10.3
1974	343.7	56.8	16.5	2.8	–2.6
1975	394.7	66.0	16.7	51.0	9.2
1976	477.4	69.8	14.6	82.7	3.8
TQ	495.5	74.6	15.1	18.1	4.9
1977	549.1	95.5	17.4	53.6	20.9
1978	607.1	121.0	19.9	58.0	25.4
1979 [3]	640.3	120.3	18.8	33.2	N/A
1980	711.9	121.7	17.1	71.6	1.4
1981	789.4	130.7	16.6	77.5	9.0
1982	924.6	140.6	15.2	135.2	9.9
1983	1,137.3	160.1	14.1	212.7	19.5
1984	1,307.0	175.5	13.4	169.7	15.4
1985 [3]	1,507.3	222.9	14.8	200.3	N/A
1986	1,740.6	265.5	15.3	233.4	42.7
1987	1,889.8	279.5	14.8	149.1	14.0
1988	2,051.6	345.9	16.9	161.9	66.4
1989	2,190.7	394.9	18.0	139.1	49.0
1990 [3]	2,411.6	440.3	18.3	220.8	N/A
1991	2,689.0	477.3	17.7	277.4	37.0
1992	2,999.7	535.2	17.8	310.7	57.9
1993	3,248.4	591.3	18.2	248.7	56.1

[12] The debt calculated by the Bureau of Economic Analysis, Department of Commerce, is different, though similar in size, because of a different method of valuing the securities.

[13] Table 16–6 does not show the increase in foreign holdings in 1995 because of a benchmark revision. As explained in footnote 3 to that table, a benchmark revision reduced the estimated holdings as of December 1994 (by $47.9 billion). Because estimates of foreign holdings were not revised retroactively, the increase in 1995 was more than the difference between the beginning and end of year amounts as now calculated. Before the benchmark revision, the increase was estimated to be $192.6 billion.

Table 16–6. FOREIGN HOLDINGS OF FEDERAL DEBT—Continued

(Dollar amounts in billions)

Fiscal Year	Debt held by the public			Borrowing from the public	
	Total	Foreign [1]	Percentage foreign	Total [2]	Foreign [1]
1994	3,433.1	655.8	19.1	184.7	64.5
1995 [3]	3,604.4	800.4	22.2	171.3	N/A
1996	3,734.1	978.1	26.2	129.7	177.7
1997	3,772.3	1,218.2	32.3	38.3	240.0
1998	3,721.1	1,216.9	32.7	–51.2	–1.2
1999 [3]	3,632.4	1,281.4	35.3	–88.7	N/A
2000 [3]	3,409.8	1,057.9	31.0	–222.6	N/A
2001	3,319.6	1,005.5	30.3	–90.2	–52.3
2002 [3]	3,540.4	1,200.8	33.9	220.8	N/A
2003	3,913.4	1,454.2	37.2	373.0	253.4
2004	4,295.5	1,836.6	42.8	382.1	382.4
2005	4,592.2	2,070.0	45.1	296.7	233.4

N/A = Not available.

[1] Estimated by Treasury Department. These estimates exclude agency debt, the holdings of which are believed to be small. The data on foreign holdings are recorded by methods that are not fully comparable with the data on debt held by the public. Projections of foreign holdings are not available.

[2] Borrowing from the public is defined as equal to the change in debt held by the public from the beginning of the year to the end, except to the extent that the amount of debt is changed by reclassification.

[3] Benchmark revisions reduced the estimated foreign holdings of the Federal debt as of December 1978; increased the estimated foreign holdings as of December 1984 and December 1989; reduced the estimated holdings as of December 1994 and March 2000; and increased the estimated holdings as of June 2002. A conceptual revision increased the estimated foreign holdings as of 1999. The change in debt that is recorded as held by foreign residents in these fiscal years reflects the benchmark or conceptual revisions as well as the net purchases of Federal securities. Borrowing is therefore not shown in these years.

Foreign holdings of Federal debt are around 15–20 percent of the foreign-owned assets in the United States, depending on the method of measuring total assets. The foreign purchases of Federal debt securities do not measure the full impact of the capital inflow from abroad on the market for Federal debt securities. The capital inflow supplies additional funds to the credit market generally, and thus affects the market for Federal debt. For example, the capital inflow includes deposits in U.S. financial intermediaries that themselves buy Federal debt.

Federal, Federally Guaranteed, and Other Federally Assisted Borrowing

The effect of the Government on borrowing in the credit market arises not only from its own borrowing to finance Federal operations but also from its assistance to certain borrowing by the public. The Government guarantees borrowing by private and other non-Federal lenders, which is another term for guaranteed lending. In addition to its guarantees, it has established private corporations called “Government-sponsored enterprises,” or GSEs, to provide financial intermediation for specified public purposes; it exempts the interest on most State and local government debt from income tax; it permits mortgage interest to be deducted in calculating taxable income; and it insures the deposits of banks and thrift institutions, which themselves make loans.

Federal credit programs and other forms of assistance are discussed in Chapter 7 of this volume, “Credit and Insurance.” Detailed data are presented in tables at the end of that chapter.

FEDERAL RECEIPTS AND COLLECTIONS

17. FEDERAL RECEIPTS

Receipts (budget and off-budget) are taxes and other collections from the public that result from the exercise of the Federal Government's sovereign or governmental powers. The difference between receipts and outlays determines the surplus or deficit.

The Federal Government also collects income from the public from market-oriented activities. Collections from these activities, which are subtracted from gross outlays, rather than added to taxes and other governmental receipts, are discussed in the following Chapter.

Total receipts in 2007 are estimated to be $2,415.9 billion, an increase of $130.4 billion or 5.7 percent relative to 2006. Receipts are projected to grow at an average annual rate of 5.9 percent between 2007 and 2011, rising to $3,034.9 billion. This growth in receipts is largely due to assumed increases in incomes resulting from both real economic growth and inflation.

As a share of GDP, receipts are projected to increase from 17.5 percent in 2006 to 17.6 percent in 2007. The receipts share of GDP is projected to increase to 17.9 percent in 2011.

Table 17–1. RECEIPTS BY SOURCE—SUMMARY

(in billions of dollars)

	2005 Actual	Estimate					
		2006	2007	2008	2009	2010	2011
Individual income taxes	927.2	997.6	1,096.4	1,208.5	1,268.4	1,370.1	1,466.9
Corporation income taxes	278.3	277.1	260.6	268.5	277.1	282.0	292.0
Social insurance and retirement receipts	794.1	841.1	884.1	932.1	980.7	1,037.4	1,096.7
(On-budget)	(216.6)	(231.1)	(241.8)	(253.0)	(264.5)	(278.9)	(295.1)
(Off-budget)	(577.5)	(610.0)	(642.3)	(679.1)	(716.2)	(758.5)	(801.6)
Excise taxes	73.1	73.5	74.6	75.9	77.5	78.9	83.1
Estate and gift taxes	24.8	27.5	23.7	24.4	26.0	20.1	1.6
Customs duties	23.4	25.9	28.1	31.4	31.7	34.0	36.2
Miscellaneous receipts	33.0	42.8	48.4	49.4	52.7	55.7	58.4
Total receipts	2,153.9	2,285.5	2,415.9	2,590.3	2,714.2	2,878.2	3,034.9
(On-budget)	(1,576.4)	(1,675.5)	(1,773.5)	(1,911.1)	(1,998.0)	(2,119.7)	(2,233.3)
(Off-budget)	(577.5)	(610.0)	(642.3)	(679.1)	(716.2)	(758.5)	(801.6)
Total receipts as a percentage of GDP	17.5	17.5	17.6	17.8	17.7	17.9	17.9

Table 17–2. EFFECT ON RECEIPTS OF CHANGES IN THE SOCIAL SECURITY TAXABLE EARNINGS BASE

(In billions of dollars)

	Estimate				
	2007	2008	2009	2010	2011
Social security (OASDI) taxable earnings base increases:					
$94,200 to $98,700 on Jan. 1, 2007	2.3	6.1	6.8	7.6	8.6
$98,700 to $103,500 on Jan. 1, 2008	....	2.5	6.5	7.3	8.2
$103,500 to $108,600 on Jan. 1, 2009	....	....	2.6	7.0	7.8
$108,600 to $114,000 on Jan. 1, 2010	....	....	....	2.8	7.4
$114,000 to $119,400 on Jan. 1, 2011	....	....	....	....	2.8

Chart 17–1. Major Provisions of the Tax Code Under the 2001, 2003 and 2004 Tax Cuts

Provision	2003	2004	2005	2006	2007	2008	2009	2010	2011
Individual Income Tax Rates	Rates reduced to 35, 33, 28, and 25 percent								Rates increased to 39.6, 36, 31, and 28 percent
10 Percent Bracket	Top of bracket increased to $7,000/$14,000 for single/joint filers and inflation-indexed								Bracket eliminated, making lowest bracket 15 percent
15 Percent Bracket for Joint Filers	Top of bracket for joint filers increased to 200 percent of top of bracket for single filers								Top of bracket for joint filers reduced to 167 percent of top of bracket for single filers
Standard Deduction for Joint Filers	Standard deduction for joint filers increased to 200 percent of standard deduction for single filers								Standard deduction for joint filers reduced to 167 percent of standard deduction for single filers
Child Credit	Tax credit for each qualifying child under age 17 increased to $1,000								Tax credit for each qualifying child under age 17 reduced to $500
Estate Taxes	Top rate reduced to 49 percent	Top rate reduced to 48 percent Exempt amount increased to $1.5 million	Top Rate reduced to 47 percent	Top rate reduced to 46 percent Exempt amount increased to $2 million	Top rate reduced to 45 percent		Exempt amount increased to $3.5 million	Estate tax repealed	Top rate increased to 60 percent Exempt amount reduced to $1 million
Small Business Expensing	Deduction increased to $100,000, reduced by amount qualifying property exceeds $400,000, and both amounts inflation-indexed Includes software					Deduction declines to $25,000, reduced by amount qualifying property exceeds $200,000 and amounts not inflation-indexed Does not apply to software			
Capital Gains	Tax rate on capital gains reduced to 5/15 percent					Tax on capital gains eliminated for taxpayers in 10/15 percent tax brackets	Tax rate on capital gains increased to 10/20 percent		

Chart 17–1. Major Provisions of the Tax Code Under the 2001, 2003 and 2004 Tax Cuts—Continued

Provision	2003	2004	2005	2006	2007	2008	2009	2010	2011
Dividends	Tax rate on dividends reduced to 5/15 percent					Tax on dividends eliminated for taxpayers in 10/15 percent tax brackets	Dividends taxed at standard income tax rates		
Bonus Depreciation	Bonus depreciation increased to 50 percent of qualified property aquired after 5/5/03		Bonus depreciation expires						
Alternative Minimum Tax	AMT exemption amount increased to $40,250/$58,000 for single/joint filers			AMT exemption amount reduced to $33,750/ $45,000 for single /joint filers					

ENACTED LEGISLATION

Several laws were enacted in 2005 that have an effect on governmental receipts. The major legislative changes affecting receipts are described below.

ENERGY POLICY ACT OF 2005

This Act, which was signed by President Bush on August 8, 2005, laid the groundwork for a more energy-independent United States. The major provisions of this Act were designed to help secure our energy future and reduce our dependence on foreign sources of energy by encouraging conservation and efficiency, diversifying our energy supply with alternative and renewable sources, expanding domestic energy production in an environmentally sensitive way, and modernizing our electricity infrastructure. The major provisions of this Act affecting receipts are described below.

Energy Infrastructure

Extend and modify tax credit for producing electricity from certain renewable resources.—Taxpayers are allowed a tax credit for electricity produced from wind, biomass, landfill gas and certain other sources. Biomass includes closed-loop biomass (organic material from a plant grown exclusively for use at a qualifying facility to produce electricity) and open-loop biomass (biomass from agricultural livestock waste nutrients or cellulosic waste material derived from forest-related resources, agricultural sources, and other specified sources). Closed-loop biomass may be co-fired with coal, with other biomass, or with both coal and other biomass. The credit rate is 1.5 cents per kilowatt hour for electricity produced from wind and closed-loop biomass and 0.75 cent per kilowatt hour for electricity produced from open-loop biomass and landfill gas (both rates are adjusted for inflation since 1992). To qualify for the credit under prior law, the electricity had to be produced at a facility placed in service before January 1, 2006 unless it was a refined coal facility, for which the placed-in-service date was extended three years, through December 31, 2008. This Act extended the placed-in-service date by two years, through December 31, 2007, for electricity produced from all qualifying facilities, except those producing electricity from solar energy and refined coal. For facilities producing electricity from solar energy and refined coal, the placed-in-service termination dates of prior law were not changed.

This Act expanded the energy production credit to apply to electricity produced from hydropower at a facility: (1) that produced hydroelectric power before August 8, 2005 and to which efficiency improvements or additions to capacity are made after August 8, 2005 and before January 1, 2008; or (2) that did not produce hydroelectric power before August 8, 2005 and to which turbines or other electricity generating equipment is added after August 8, 2005 and before January 1, 2008. This Act also expanded the credit to apply to sales of coal produced from coal reserves that on June 14, 2005 were: (1) owned by a tribe of Indians recognized by the United States; or (2) were held in trust for a tribe of Indians or its members by the United States. The credit for Indian coal is $1.50 per ton for coal sold after December 31, 2005 and before January 1, 2010, and $2.00 per ton for coal sold after December 31, 2009 and before January 1, 2013 (both rates are adjusted for inflation).

Under prior law, cooperatives were not allowed to pass any portion of the energy production credit through to their patrons. Under this Act, eligible cooperatives may elect to pass any portion of the credit through to their patrons.

Provide tax credits for investment in clean coal facilities.—Under this Act, a 20-percent tax credit was provided for qualified investments in electricity production facilities using integrated gasification combined cycle (IGCC) technologies and a 15-percent credit was provided to qualified investments in electricity production facilities using other advanced coal-based technologies. Qualified projects must be economically feasible and use the appropriate clean coal technologies. The Secretary of Treasury, in consultation with the Secretary of Energy, may allocate $800 million of credits to IGCC projects and $500 million of credits to projects using other advanced coal-based technologies. A 20-percent tax credit was also provided for investment in certified gasification projects. The total amount of gasification credits allocable by the Secretary of the Treasury is $350 million. These three credits are effective for qualified investments made after August 8, 2005.

Modify treatment of nuclear decommissioning funds.—Under prior law, deductible contributions to nuclear decommissioning funds were limited to the amount included in the taxpayer's cost of service to ratepayers. In addition, deductible contributions were not permitted to exceed the amount the Internal Revenue Service (IRS) determined to be necessary to provide for level funding of an amount equal to the taxpayer's post-1983 decommissioning costs. Effective for taxable years beginning after December 31, 2005, this Act repealed the cost-of-service requirement for deductible contributions to a nuclear decommissioning fund and expanded the deduction to apply to pre-1984 decommissioning costs. As provided under prior law, deductible contributions may not be made more rapidly than required to provide for level funding of the taxpayer's decommissioning costs.

Reduce recovery period for certain assets used in the transmission of electricity.—Under the Modified Accelerated Cost Recovery System (MACRS) of current law, assets used in the transmission and distribution of electricity for sale may be depreciated over 20 years. This Act reduced the recovery period for certain assets used in the transmission of electricity for sale to 15 years. To qualify for the reduced recovery period: (1) the original use of the property must commence with the taxpayer after April 11, 2005; (2) the property must be used in the transmission at 69 or more kilovolts of electricity for sale; and (3) the property must not be subject to a binding contract on or before April 11, 2005 or, if self-constructed, the taxpayer or a related party must not have started construction on or before such date.

Provide 84-month amortization for certain air pollution control facilities.—A taxpayer may elect to recover a portion of the cost of a certified pollution control facility over a period of 60 months under current law. To be eligible, the pollution control facility must be new, used in connection with a plant in operation before January 1, 1976, certified as being in conformity with State and Federal environmental laws, and meet certain other requirements. The amortizable portion is 100 percent if the facility has a depreciation recovery period of 15 years or less; otherwise, the portion equals 15 divided by the recovery period. This Act provided 84-month amortization to a similar portion of the cost of certified air pollution control facilities used in connection with an electric generation plant that is primarily coal fired and that was not in operation before January 1, 1976. For an air pollution control facility to be eligible for cost recovery over a period of 84 months: (1) its construction, reconstruction, or erection must be completed after April 11, 2005; or (2) it must be acquired after April 11, 2005 and its original use must commence with the taxpayer after that date.

Domestic Fossil Fuel Security

Allow expensing of equipment used in the refining of liquid fuels.—This Act allowed a taxpayer to elect to treat 50 percent of the cost of qualified refinery investments as a current expense. An eligible investment must be placed in service after August 8, 2005 and before January 1, 2012, and cannot be subject to a written binding construction contract in effect on or before June 14, 2005. If self-constructed, construction must begin after June 14, 2005 and before January 1, 2008; otherwise, a written binding contract for construction must be entered into before January 1, 2008, or the property must be placed in service before that date. The original use of the property must commence with the taxpayer, and the property must meet all applicable environmental laws. If part of an existing refinery, the investment must increase refining capacity by at least five percent or increase the throughput of qualified fuels by at least 25 percent. Qualified fuels include oil produced from shale and tar sands. As a condition of eligibility, refineries of liquid fuels must report to the IRS on refinery operations.

Reduce recovery period for certain natural gas distribution lines.—Under MACRS, natural gas distribution lines are assigned a 20-year recovery period. This Act established a 15-year recovery period for natural gas distribution lines, the original use of which begins with the taxpayer after April 11, 2005 and before January 1, 2011. The shortened recovery period does not apply to property subject to a binding contract on or before April 11, 2005, or, if self-constructed, the taxpayer or a related party must not have started construction on or before such date.

Treat natural gas gathering lines as seven-year property.—This Act clarified existing law by establishing a statutory seven-year recovery period for natural gas gathering lines, the original use of which commences with the taxpayer after April 11, 2005. In addition, no depreciation adjustment must be made with respect to this property in computing a taxpayer's alternative minimum taxable income.

Provide two-year amortization for certain geological and geophysical expenditures.—Geological and geophysical expenditures (G&G costs) are costs incurred by a taxpayer for the purpose of obtaining and accumulating data that will serve as the basis for the acquisition and retention of mineral properties by taxpayers exploring for minerals. A key issue with regard to such costs has been whether or not they are capital in nature. Various courts have held that G&G costs are capital and allocable to the cost of the property acquired or retained; IRS administrative rulings have provided further guidance regarding the definition and proper tax treatment of such costs. Under this Act, G&G costs paid or incurred in taxable years beginning after August 8, 2005, in connection with oil and gas exploration in the United States, may be amortized over two years.

Conservation and Energy Efficiency

Provide personal tax credit for certain solar energy equipment.—This Act provided a new nonrefundable tax credit for individuals who purchase qualified solar energy equipment to generate electricity (photovoltaic equipment) or heat water (solar water heating equipment) for use in a dwelling unit that the individual uses as a residence. Expenditures that are properly allocable to a swimming pool or hot tub do not qualify for the credit. The credit, which applies to property placed in service after December 31, 2005 and before January 1, 2008, is equal to 30-percent of the cost of the equipment and its installation, with a maximum credit of $2,000 for each system. A 30-percent credit for the cost of qualified fuel cell power plants, not to exceed $500 for each 0.5 kilowatt of capacity, was also provided.

Provide tax credit for energy-efficient improvements to principal residences.—This Act provided a nonrefundable 10-percent tax credit to homeowners for the cost of purchasing qualified energy efficient improvements installed in or on a dwelling unit in the United States that is used as their principal residence. Qualified energy efficient improvements include any energy efficiency building envelope component that meets or exceeds the prescriptive criteria for such a component established by the 2000 International Energy Conservation Code as supplemented and in effect on August 8, 2005. Building envelope components are: (1) insulation materials or systems that are specifically and primarily designed to reduce the heat loss or gain for a dwelling; (2) exterior windows (including skylights) and doors; and (3) metal roofs with appropriate pigmented coating specifically and primarily designed to reduce the heat gain for a dwelling. The credit, which applies to property placed in service after December 31, 2005 and before January 1, 2008, may not exceed $500 over all taxable years, and no more than $200 of such credit may be attributable to expenditures on windows.

This Act also provided a tax credit to homeowners for the cost of residential energy property installed in or on a dwelling unit in the United States that is used as their principal residence. Residential energy property includes: (1) advanced main air circulating fans; (2) qualified natural gas, propane, or oil furnaces and hot water boilers; and (3) energy-efficient building property (certain electric and geothermal heat pumps, air conditioners, and natural gas, propane, or oil water heaters). The credit, which applies to property placed in service after December 31, 2005 and before January 1, 2008, may not exceed $50 per fan, $150 for each furnace or boiler, and $300 for each item of energy-efficient building property.

Provide tax credit for the purchase of qualified hybrid, fuel cell and alternative fuel motor vehicles.—A qualified fuel cell vehicle is propelled by power derived from one or more cells that convert chemical energy directly into electricity. This Act provided a credit for the purchase of fuel cell vehicles, effective for vehicles placed in service after December 31, 2005 and before January 1, 2015. The amount of the credit is equal to a base credit amount, determined by the weight class of the vehicle and, in the case of automobiles and light trucks, an additional credit amount, determined by the rated fuel economy of the vehicle compared to the 2002 model year city fuel economy rating for vehicles of various weight classes. The base credit amount ranges from $8,000 ($4,000 after December 31, 2009) for vehicles with a gross weight less than or equal to 8,500 pounds, to $40,000 for vehicles weighting over 26,000 pounds. The additional credit amount ranges from $1,000 for a fuel economy rating that is at least 150 percent, but less than 175 percent of the 2002 model year city fuel economy rating, to $4,000 for a fuel economy rating that is at least 300 percent of the 2002 model year city fuel economy rating.

A qualified alternative fuel motor vehicle operates only on qualifying alternative fuels (compressed natural gas, liquefied natural gas, liquefied petroleum gas, hydrogen and any liquid fuel that is at least 85 percent methanol) and is incapable of operating on gasoline or diesel fuel (except to the extent that gasoline or diesel fuel is part of a qualified mixed fuel). This Act provided a credit for the purchase of alternative fuel vehicles, effective for vehicles placed in service after December 31, 2005 and before January 1, 2011. The credit is equal to 50 percent of the incremental cost of the vehicle (the excess of the manufacturer's suggested retail price over the manufacturer's suggested retail price for a comparable gasoline or diesel vehicle), plus an additional 30 percent if the vehicle meets certain emissions standards. Depending on the weight of the vehicle, a maximum allowable incremental cost is specified, ranging from $5,000 for a vehicle weighing less than or equal to 8,500 pounds, to $40,000 for a vehicle weighing more than 26,000 pounds. The total credit for the purchase of a new alternative fuel vehicle may not exceed $4,000 for a vehicle weighing less than or equal to 8,500 pounds and $32,000 for a vehicle weighing more than 26,000 pounds. Certain mixed fuel vehicles (vehicles that use a combination of an alternative fuel and a petroleum-based fuel) are eligible for a reduced credit. Specifically, if the vehicle operates on a mixed fuel that is at least 75 percent alternative fuel, the vehicle is eligible for 70 percent of the otherwise allowable alternative fuel vehicle credit and if the vehicle operates on a mixed fuel that is at least 90 percent alternative fuel, the vehicle is eligible for 90 percent of the otherwise allowable credit.

A qualified hybrid vehicle is a motor vehicle that draws propulsion energy from on-board sources of stored energy that include both an internal combustion engine or heat engine using combustible fuel and a rechargeable energy storage system. This Act provided a credit for the purchase of qualified hybrid motor vehicles placed in service after December 31 2005 and before January 1, 2011 (January 1, 2010 in the case of a qualified hybrid vehicle weighing more than 8,500 pounds). For a qualified hybrid automobile or light truck weighing less than or equal to 8,500 pounds, or a lean-burn technology motor vehicle, the credit consists of two components: (1) a fuel economy credit of $400 to $2,400, depending upon the rated fuel economy of the vehicle compared to the 2002 model year standard; and (2) a conservation credit of $250 to $1,000, depending upon the estimated lifetime fuel savings of the vehicle compared to a comparable 2002 model year vehicle. For a qualified hybrid vehicle weighing more than 8,500 pounds (a medium or heavy truck), the amount of credit is determined by the estimated increase in fuel economy and the incremental cost of the hybrid vehicle compared to a vehicle comparable in weight, size and use that is powered solely by a gasoline or diesel internal combustion engine. Depending on the weight of the vehicle, a maximum incremental cost is specified, ranging from $7,500 for a vehicle weighing more than 8,500 pounds but less than or equal to 14,000 pounds, to $30,000 for a vehicle weighing more than 26,000 pounds. For a vehicle that achieves a fuel economy increase of at least 30 percent but less than 40 percent, the credit is equal to 20 percent of the incremental cost of the vehicle. The credit increases to 30 percent of the incremental cost for a vehicle that achieves a fuel economy increase of at least 40 percent but less than 50 percent, and to 40 percent of the incremental cost for a vehicle that achieves a fuel economy increase of 50 percent or more. In the case of passenger automobiles and light trucks, a limitation is imposed on the number of qualified hybrid motor vehicles and advanced lean-burn technology motor vehicles sold by each manufacturer. Taxpayers may claim the full amount of the allowable credit up to the end of the first calendar quarter following the quarter in which the manufacturer from whom they purchased their vehicle records its 60,000th sale of a hybrid or advanced lean-burn technology passenger automobile or light truck. The credit declines to one half the otherwise allowable amount in the subsequent two quarters, to one quarter of the otherwise allowable amount in the next two quarters, and then expires.

Provide additional incentives to promote energy conservation and efficiency.—This Act provided a number of additional incentives to promote energy conservation and efficiency, which included: (1) a tax deduction for energy-efficient property installed during the construction of a commercial building; (2) tax credits for the purchase of qualified fuel cell and stationary micro-turbine power plants; (3) a tax credit for the construction of qualified new energy-efficient homes; and (4) a tax credit for the production of certain energy-efficient dishwashers, clothes washers and refrigerators.

Offsets

Reinstate excise taxes deposited in the Oil Spill Liability Trust Fund.—Between December 31, 1989 and January 1, 1995, a five-cent-per-barrel tax was imposed on: (1) crude oil received at a U.S. refinery; (2) imported petroleum products received for consumption, use or warehousing; and (3) any domestically produced crude oil that was exported from the United States if, before exportation, no taxes were imposed on the crude oil. Collections of the tax, which were deposited in the Oil Spill Liability Trust Fund, were used for several purposes, including the payment of costs associated with responding to and removing oil spills. The tax was imposed only if the unobligated balance in the Oil Spill Liability Trust Fund was less than $1 billion. This Act reinstated this tax, effective April 1, 2006 through December 31, 2014. The tax will be suspended during a calendar quarter if, at the close of the preceding quarter, the unobligated balance in the Fund exceeds $2.7 billion.

Extend excise taxes deposited in the Leaking Underground Storage Tank (LUST) Trust Fund.—An excise tax is imposed, generally at a rate of 0.1 cents per gallon, on gasoline and other liquid motor fuels used on highways, in aviation, on inland waterways, and in diesel-powered trains. The tax, which is deposited in the LUST Trust Fund, was scheduled to expire on October 1, 2005 under prior law. This Act extended the tax through September 30, 2011. In addition, the tax was expanded to apply to dyed fuel, which was exempt from the tax under prior law and all other liquid fuel that is not exported.

Modify recapture of section 197 amortization.—Gain on the sale of depreciable property must be recaptured as ordinary income to the extent of depreciation deductions previously claimed. The recapture amount is computed separately for each item of property that is sold. This Act modified the recapture rules of current law with respect to dispositions of section 197 intangibles. Section 197 intangibles include goodwill; a patent, copyright, formula, design or similar item; any license, permit, or other right granted by a governmental unit or agency; and any franchise, trademark, or trade name. Under this Act, multiple section 197 intangibles sold in a single transaction or in a series of transactions after August 8, 2005 are treated as a single asset for the purpose of calculating the amount of gain to be recaptured as ordinary income. This rule does not apply to any amortizable section 197 intangible for which adjusted basis exceeds fair market value.

SAFE, ACCOUNTABLE, FLEXIBLE, EFFICIENT TRANSPORTATION EQUITY ACT: A LEGACY FOR USERS

This Act, which was signed by President Bush on August 10, 2005, reauthorized Federal spending for surface transportation programs through 2009, extended Federal highway taxes through 2011, and made numerous changes to transportation laws affecting safety, the environment, and other matters. The major provisions of this Act affecting receipts are described below.

Trust Fund Reauthorization

Extend excise taxes deposited in the Highway Trust Fund.—Excise taxes imposed on nonaviation gasoline, diesel fuel, kerosene, special motor fuels, heavy highway vehicles, and tires for heavy highway vehicles generally are deposited in the Highway Trust Fund. Taxes deposited in the Highway Trust Fund are imposed on nonaviation gasoline at a rate of 18.3 cents per gallon, on diesel fuel and kerosene at a rate of 24.3 cents per gallon, and on special motor fuels at varying rates. Under prior law, these tax rates were scheduled to fall to 4.3 cents per gallon (or comparable rates in the case of special motor fuels) on October 1, 2005. A tax equal to 12 percent of the sales price is imposed on the first retail sale of heavy highway vehicles (generally, trucks with a gross weight greater than 33,000 pounds, trailers with a gross weight greater than 26,000 pounds, and highway tractors). In addition, a heavy highway vehicle use tax of up to $550 per year is imposed on highway vehicles with a gross weight of at least 55,000 pounds. A tax is also imposed on tires with a rated load capacity exceeding 3,500 pounds, generally at a rate of 0.945 cent per pound of excess. Under prior law, the taxes on heavy highway vehicles and tires for heavy highway vehicles were scheduled to expire on September 30, 2005; the heavy vehicle use tax was scheduled to expire on September 30, 2006. This Act extended the taxes on nonaviation gasoline, diesel fuel, kerosene, special motor fuels, heavy highway vehicles, tires for heavy highway vehicles, and the use of heavy highway vehicles at their prior law rates through September 30, 2011.

Eliminate Aquatic Resources Trust Fund and create Sport Fish Restoration and Boating Trust Fund.—Under prior law, 13.5 cents per gallon of the excise taxes imposed on motorboat gasoline and special motor fuels, and on gasoline used as a fuel in the nonbusiness use of small-engine outdoor power equipment, was transferred from the Highway Trust Fund to the Land and Water Conservation Fund and to the Boat Safety and Sport Fish Restoration Accounts of the Aquatic Resources Trust Fund. The remaining 4.8 cents per gallon of these taxes was retained in the General Fund of the Treasury. Amounts transferred from the Highway Trust Fund to the Land and Water Conservation Fund and the Aquatic Resources Trust Fund were allocated as follows: (1) Up to $70 million in annual collections was transferred to the Boat Safety Account, subject to an overall limit equal to the amount that would not cause the Boat Safety Account to have an unobligated balance in excess of $70 million. (2) The next $1 million in annual collections was transferred to the Land and Water Conservation Fund. (3) All remaining annual collections were transferred to the Sport Fish Restoration Account. As explained in the preceding discussion of the Highway Trust Fund, these excise taxes were scheduled to decline to 4.3 cents per gallon on September 30, 2005; in addition, the retention of 4.8 cents per gallon of these taxes in the General Fund of the Treasury was scheduled to expire on that date.

Effective October 1, 2005, this Act eliminated the Aquatic Resources Trust Fund and created the Sport Fish Restoration and Boating Trust Fund. This Act also extended the taxes on motorboat fuels and on gasoline used as a fuel in the nonbusiness use of small-engine outdoor power equipment at their prior law rates through September 30, 2011, but did not extend the retention of 4.8 cents per gallon of these taxes in the General Fund of the Treasury. Therefore, effective October 1, 2005, 18.3 cents per gallon of the taxes on these fuels is deposited in the Highway Trust Fund and then transferred to the Land and Water Conservation Fund and to the Sport Fish Restoration and Boating Trust Fund as follows: (1) The first $1 million in annual collections is transferred to the Land and Water Conservation Fund. (2) All remaining annual collections are transferred to the Sport Fish Restoration and Boating Trust Fund.

Excise Tax Simplification and Reform

Modify excise taxes on the retail sale of certain automobiles, heavy trucks and trailers.—An excise tax is imposed on the sale of automobiles weighing less than or equal to 6,000 pounds with a fuel economy less than or equal to 22.5 miles per gallon. The tax ranges from $1,000 to $7,700, depending on the fuel economy of the automobile. Under prior law, the tax applied to all limousines, regardless of their weight. Effective for sales after September 30, 2005, this Act repealed the tax with respect to limousines weighing more than 6,000 pounds.

A tax equal to 12 percent of the sales price is imposed on the first retail sale of heavy highway vehicles. Under prior law, the tax was imposed on trucks with a gross weight greater than 33,000 pounds; trailers with a gross weight greater than 26,000 pounds; and highway tractors, regardless of weight. Effective for sales after September 30, 2005, this Act repealed the tax with respect to tractors weighing less than or equal to 19,500 pounds, provided that when combined with a towed vehicle, the total weight does not exceed 33,000 pounds.

Modify taxation of alternative fuels.—In general, nonaviation gasoline is taxed at 18.3 cents per gallon, aviation gasoline is taxed at 19.3 cents per gallon, and diesel fuel and kerosene are taxed at 24.3 cents per gallon. Although most special motor fuels are subject to tax at 18.3 cents per gallon, certain special motor fuels and compressed natural gas are taxed at reduced rates. Effective for sales after September 30, 2006, this Act increased the tax on certain special motor fuels as follows: (1) Liquefied petroleum gas and P Series fuels (as defined by the Secretary of Energy) will be taxed at 18.3 cents per gallon. (2) Compressed natural gas will be taxed at 18.3 cents per energy equivalent of a gallon of gasoline. (3) Liquefied natural gas, any liquid fuel derived from coal (other than ethanol or methanol) and liquid hydrocarbons derived from biomass will be taxed at 24.3 cents per gallon. This Act also created two new excise tax credits—the alternative fuel credit and the alternative fuel mixture credit—for the sale or use of alternative fuels. For purposes of the credits, alternative fuels are defined as liquefied petroleum gas, P Series fuels (as defined by the Secretary of Energy), compressed or liquefied natural gas, liquefied hydrogen, liquid fuel derived from coal through the Fisher-Tropsch process, and liquid hydrocarbons derived from biomass. The alternative fuel credit is 50 cents for each gallon of alternative fuel or gasoline-gallon equivalent of nonliquid alternative fuel sold by the taxpayer for use as a motor fuel in a motor vehicle or motorboat. The alternative fuel mixture credit is 50 cents for each gallon of alternative fuel used in producing an alternative fuel mixture for sale or use in a trade or business of the taxpayer. These credits, which are effective for qualified fuels sold or used after October 1, 2006 and before October 1, 2009 (October 1, 2014 for liquefied hydrogen), are to be paid from the General Fund of the Treasury.

Cap excise tax on certain fishing equipment.—Effective for sales after September 30, 2005, the 10-percent excise tax imposed on the sale of fishing rods and poles is capped at $10.00 on each rod and pole sold.

Modify aviation excise taxes.—Fuel used on a farm for farming purposes is exempt from Federal excise taxes on fuel. Under prior law, crop-dusters, instead of farm owners and operators, were allowed to claim a refund for taxes on aviation fuel consumed while operating over a farm if they had written consent from the farm owner or operator. Fuel consumed traveling to and from the farm was not exempt from Federal excise taxes on fuel. This Act repealed the requirement that crop-dusters receive written consent to apply for a refund and clarified that travel to and from a farm is exempt use, effective for fuel used after September 30, 2005.

Domestic passenger tickets are subject to an air passenger ticket tax equal to 7.5 percent of the ticket price, plus $3.20 per domestic flight segment. Amounts paid to persons engaged in the business of transporting property by air for hire are subject to an air cargo tax of 6.25 percent. The air passenger ticket tax does not apply to: (1) transportation by helicopter if the helicopter does not use Federally funded airport and airway services and is used for certain timber operations or the exploration, development or removal of oil, gas, or hard minerals; and (2) helicopters and fixed-wing aircraft that provide emergency medical services. In addition, the $3.20 tax on flight segments does not apply to a domestic segment beginning or ending at a rural airport. Neither the air passenger ticket tax nor the air cargo tax apply to transportation by an aircraft having a maximum certificated takeoff weight of 6,000 pounds or less unless the aircraft is operated on an established line. Under prior law, a rural airport was defined as an airport that: (1) had fewer than 100,000 passengers departing by air during the second preceding calendar year and was located more than 75 miles from a larger airport; or (2) was receiving essential air service subsidy payments as of August 5, 1997. This Act expanded the definition of a rural airport, effective October 1, 2005, to include airports not connected by paved roads to another airport and having fewer than 100,000 passengers departing on flight segments of at least 100 miles during the second preceding calendar year. This Act also expanded the types of transportation exempt from the passenger ticket and/or air cargo tax, effective with respect to transportation beginning after September 30, 2005. The expansions included the following: (1) The exemption of transportation by a seaplane from the air passenger ticket tax and the air cargo tax, provided the take off is from, and the landing is on, water, and the places from which such landings and takeoffs occur have not received or are not receiving financial assistance from the Airport and Airway Trust Fund. (2) The exemption of fixed-wing aircraft engaged in timber operations from aviation excise taxes if they are not using Federally-funded airport and airway services. (3) The exemption of sightseeing flights from the passenger ticket tax.

Modify alcohol-related excise taxes.—The 2004 job creation act suspended the special occupational taxes imposed on producers and others engaged in the marketing of distilled spirits, wine, and beer, for the period July 1, 2005 through June 30, 2008. This Act repealed these taxes effective July 1, 2008. This Act also: (1) provided an income tax credit to eligible wholesalers, distillers, and importers of distilled spirits for the cost of carrying tax-paid products in inventory, effective for taxable years beginning after September 30, 2005; and (2) allowed certain domestic producers and importers of distilled spirits, wine, and beer with annual excise tax liability of $50,000 or less attributable to these articles in the preceding calendar year to file returns and pay taxes quarterly (rather than semi-monthly) in most cases effective for quarterly periods beginning after December 31, 2005.

Provide custom gunsmiths an exemption from taxes on firearms and ammunition.—Sales of firearms and ammunition by the manufacturer, producer or importer generally are subject to an excise tax of 10 or 11 percent of the retail price, depending upon the type of good sold. Sales of machine guns and short-barreled firearms are exempt from the tax. This Act expanded the exemption to apply to sales of firearms, pistols, and revolvers by a person who manufactures, produces, or imports less than 50 of such articles during the calendar year. The exemption is effective for sales after September 30, 2005.

Other Provisions

Provide tax-exempt financing for highway projects and rail-truck transfer facilities.—This Act authorized $15 billion of tax-exempt bond authority to finance qualified highway or surface freight transfer facilities.

Modify treatment of kerosene for use in aviation.—In general, aviation-grade kerosene is taxed at a rate of 21.8 cents per gallon when it enters the United States, is removed from a refinery or terminal, or is sold to an unregistered person, unless there was a prior taxation upon entry or removal of the fuel. Aviation-grade kerosene may be taxed at a reduced rate, either 4.3 or zero cents per gallon, if it is removed directly into the fuel tank of an aircraft for use in commercial aviation or is for a use that is exempt from tax. Kerosene used for surface transportation is taxed at the diesel fuel rate of 24.3 cents per gallon. Under this Act, all kerosene is taxed at a rate of 24.3 cents per gallon unless it is removed directly into the fuel tank of an aircraft or is for a use that is exempt from tax. This change is effective for kerosene that enters the United States, is removed from a refinery or terminal, or is sold after September 30, 2005. If the kerosene taxed at 24.3 cents per gallon is used for aviation or tax exempt purposes, a credit or refund may be claimed.

Combat fuel fraud.—This Act included a number of provisions designed to combat fuel fraud. Under this Act: (1) Farmers who purchase clear diesel fuel must pay the excise tax on that fuel and then claim a refund for taxes paid on fuel used for farming purposes. (2) Credit card companies that allow tax-exempt fuel purchases on their cards must register with the IRS and be the party responsible for claiming refunds of the tax. (3) Blenders, importers, pipeline operators, position holders, refiners, terminal operators, and vessel operators who are registered with the IRS must reregister in the event of a change in ownership. (4) Information regarding taxable fuels destined for the United States must be transmitted electronically from the Bureau of Customs and Border Control to the IRS. (5) Operators of deep-draft ocean-going vessels used in the bulk transfer of fuel must register with the IRS.

KATRINA EMERGENCY TAX RELIEF ACT OF 2005

This Act, which was signed by President Bush on September 23, 2005, provided emergency tax relief for individuals and employers affected by Hurricane Katrina and incentives for charitable giving. For purposes of this Act, the "Hurricane Katrina disaster area" is the area with respect to which a major disaster was declared by President Bush before September 14, 2005 by reason of Hurricane Katrina and the term "core disaster area" means that portion of the Hurricane Katrina disaster area determined by the President to warrant individual or individual and public assistance. The major provisions of this Act are described below.

Tax Relief for Victims of Hurricane Katrina

Suspend certain limitations on personal casualty losses.—Under current law, a taxpayer generally is allowed to claim a deduction for any uncompensated loss of nonbusiness property arising from theft or casualty (e.g., fire, storm). Personal theft and casualty losses are deductible only if they exceed $100 per casualty or theft. In addition, aggregate net losses from casualty or theft are deductible only to the extent that they exceed 10 percent of the taxpayer's adjusted gross income (AGI). Effective for personal casualty and theft losses occurring in the Hurricane Katrina disaster area on or after August 25, 2005 and attributable to the hurricane, this Act suspended both the $100 and 10-percent-of-AGI limitations otherwise applicable under current law. In addition, losses under this provision are disregarded when applying the 10-percent-of-AGI threshold to other personal casualty or theft losses.

Extend replacement period for non-recognition of gain.—Gain realized by a taxpayer on the involuntary conversion of property generally is deferred to the extent the taxpayer purchases property similar or related in service or use to the converted property within the replacement period. The replacement period generally begins with the date of the disposition of the converted property and ends two years after the close of the first taxable year in which any part of the gain upon conversion is realized. Under current law, special rules extend the replacement period for certain real property and principal residences damaged by a Presidentially declared disaster or the terrorist attacks on September 11, 2001, and for livestock sold as the result of drought, flood, or other weather-related conditions. This Act extended from two to five years the replacement period for property in the Hurricane Katrina disaster area compulsorily or involuntarily converted on or after August 25, 2005, as a result of the hurricane.

Provide exclusion for certain cancellations of indebtedness.—Under current law, gross income generally includes any income realized by a debtor from the discharge of indebtedness, subject to certain exceptions for debtors in Title 11 bankruptcy cases, insolvent debtors, certain farm indebtedness, and certain real property business indebtedness. This Act excluded from gross income the discharge of nonbusiness debt on or after August 28, 2005 and before January 1, 2007, if the debtor's principal place of abode on August 25, 2005 was located in: (1) the core disaster area, or (2) the Hurricane Katrina disaster area and such person suffered economic loss as a result of the hurricane.

Provide special rule for purposes of computing the child tax credit and earned income tax credit.—The earned income tax credit (EITC) is a refundable credit for low-income workers, the amount of which depends on the earned income of the taxpayer and whether the taxpayer has one, more than one, or no qualifying children. Taxpayers with income below certain thresholds also are eligible for a child credit for each qualifying child, which may be refundable. Under this Act, qualified individuals were permitted to elect to use their earned income from the prior taxable year to determine eligibility for these credits for the taxable year that includes August 25, 2005 if their earned income for the taxable year that includes August 25, 2005 was less than their earned income for the preceding taxable year. Qualified individuals are those whose principal place of abode on August 25, 2005 was located in: (1) the core disaster area, or (2) in the Hurricane Katrina disaster area and who were displaced by the hurricane.

Provide special rules for mortgage revenue bonds.—Under current law State and local governments may issue mortgage revenue bonds (MRBs) to provide low-interest rate financing to qualified individuals for the purchase, improvement, or rehabilitation of owner-occupied residences. Several restrictions, including purchase price limitations, mortgagor income, and the first-time homebuyer requirement (except with regard to residences in certain targeted areas) apply to the financing of mortgages with MRBs. Effective for financing provided before January 1, 2008, this Act waived the first-time homebuyer requirement of current law with respect to financing for: (1) residences located in the core disaster area, and (2) any other residence if the mortgagor owned a principal residence in the Hurricane Katrina disaster area on August 28, 2005 that was rendered uninhabitable by the hurricane and the residence being financed is located in the same State as the prior principal residence. This Act also increased the current law limitation on home improvement loans financed with MRBs from $15,000 to $150,000 for residences located in the Hurricane Katrina disaster area, to the extent the loan is for the repair of damage caused by the hurricane.

Extend tax filing and payment deadlines.—Deadlines for the filing of tax returns and the payment of taxes, including employment and excise taxes, otherwise required on or after August 25, 2005, were extended until February 28, 2006 for taxpayers affected by Hurricane Katrina.

Authorize the Secretary of the Treasury to make adjustment regarding taxpayer and dependency status.—This Act authorized the Secretary of the Treasury to make adjustments in applying the Federal tax laws that may be necessary to ensure that taxpayers do not lose any deduction or credit or experience a change of filing status because of temporary relocations caused by Hurricane Katrina. This provision applies to taxable years beginning in 2005 and 2006.

Tax Relief for Employers

Expand eligibility for the work opportunity tax credit.—Under current law, the work opportunity tax credit is available for first-year wages paid to a qualified individual from one or more of eight targeted groups who begins work before January 1, 2006. This Act expanded eligibility for the credit to include wages paid to: (1) an individual who on August 28, 2005 had a principal place of abode in the core disaster area and is hired during the two-year period beginning on such date for a position, the principal place of employment of which is located in the core disaster area; and (2) an individual who on August 28, 2005 had a principal place of abode in the core disaster area, was displaced from such abode by reason of Hurricane Katrina, and is hired during the period beginning on such date and ending on December 31, 2005, without regard to whether the new principal place of employment is in the core disaster area.

Provide an employee retention credit to employers affected by Hurricane Katrina.—Under this Act, a 40-percent tax credit was provided to eligible employers for the first $6,000 in qualified wages paid to an eligible employee. To be eligible, an employer must have employed an average of 200 or fewer employees in a business located in the core disaster area on August 28, 2005 that was inoperable on any day beginning on that date and ending on December 31, 2005, as a result of damage caused by the hurricane. An eligible employee, with respect to an eligible employer, is one whose principal place of employment with that employer was in the core disaster zone on August 28, 2005. Qualified wages are those paid by an eligible employer to an eligible employee on any day after August 28, 2005 and before January 1, 2006 during the period beginning on the date on which the trade or business first became inoperable at the principal place of employment of the employee and ending on the date on which such trade or business resumed significant operations at such principal place of employment. Qualified wages include those paid without regard to whether the employee performs a service, performs services at a different place of employment than such principal place of employment, or performs services at such principal place of employment before significant operations have resumed.

Incentives for Charitable Giving

Suspend limitations on charitable contributions.—Deductions for charitable contributions are subject to certain limitations under current law, depending on the type of taxpayer, the property being contributed, and the donee organization. This Act suspended the current law percentage limitations for individuals who itemize deductions and corporations with respect to cash contributions to certain public charities made after

August 27, 2005 and before January 1, 2006; however, for corporations, the suspension applied only to contributions for relief efforts related to Hurricane Katrina.

Provide an exemption to taxpayers who housed individuals displaced by Hurricane Katrina.—Taxpayers who provided housing to individuals displaced by Hurricane Katrina were provided a one-time $500 exemption for each individual whom they housed. Taxpayers may claim the exemption for up to four displaced individuals, for a maximum exemption amount of $2,000. An individual displaced by Hurricane Katrina is a person (other than a spouse or dependent of the taxpayer): (1) whose principal place of abode on August 28, 2005 was in the Hurricane Katrina disaster area, (2) who is displaced from such abode, and (3) who is provided housing free of charge in the taxpayer's principal residence for a period of 60 consecutive days, which ends in the taxable year in which the exemption is claimed. For individuals whose principal place of abode on August 28, 2005 was in the Hurricane Katrina disaster area but outside the core disaster area, in order to qualify as a displaced individual, their abode must have been damaged by the hurricane or they must have been evacuated as a result of the hurricane. This provision applies to taxable years beginning in 2005 and 2006.

Increase deduction for the costs associated with the charitable use of a motor vehicle.—Taxpayers may claim a deduction for the costs associated with the use of a motor vehicle in providing donated services to charity. The deduction may be calculated by using a standard mileage rate of 14 cents per mile. This Act increased the charitable standard mileage rate to 34 cents per mile for the costs associated with the use of a vehicle in providing services to charity solely for the provision of relief related to Hurricane Katrina. In addition, this Act excluded from the gross income of a volunteer up to 48.5 cents per mile in reimbursements paid by a charitable organization to the volunteer for the costs associated with using a passenger automobile in performing such charitable work. A volunteer may not claim a deduction or credit with respect to reimbursed amounts. Certain recordkeeping requirements apply. These changes apply to such relief provided during the period beginning on August 25, 2005 and ending on December 31, 2006.

Expand enhanced deduction for contributions of food and books.—A taxpayer's deduction for charitable contributions of inventory generally is limited to the taxpayer's basis in the inventory, or, if less, the fair market value of the inventory. However, an enhanced deduction is provided to C corporations for certain contributions of inventory. This Act expanded the enhanced deduction to apply to qualified contributions of: (1) food inventory by all taxpayers (not just C corporations) engaged in a trade or business, and to (2) books to public schools by C corporations. The donated food must meet certain quality and labeling standards, and the taxpayer's total deduction for donated food inventory may not exceed 10 percent of the taxpayer's net income from the related trade or business. The donated books must be suitable for use and used by the public school in its educational programs. The enhanced deduction applies to such qualified contributions of food and books made after August 27, 2005 and before January 1, 2006.

Special Rules for the Use of Retirement Funds

Allow tax-favored and penalty-free withdrawals from retirement plans for relief related to Hurricane Katrina.—Under current law, a distribution from a qualified retirement plan, a tax-sheltered annuity (a 403(b) annuity), an eligible deferred compensation plan maintained by a State or local government (a governmental 457 plan), or an individual retirement arrangement (IRA) generally is included in the taxpayer's gross income in the year of distribution. In addition, a distribution from a qualified retirement plan, a 403(b) plan, or an IRA received before age 59 1/2, death, or disability generally is subject to a 10-percent early withdrawal tax on the amount included in income, unless an exception applies. A distribution from a qualified retirement plan, a 403(b) annuity, a governmental 457 plan, or an IRA rolled over within 60 days to another plan, annuity or IRA generally is not included in a taxpayer's gross income and not subject to the 10-percent early withdrawal tax. This Act provided an exemption from the 10-percent early withdrawal tax for qualified Hurricane Katrina distributions. A qualified Hurricane Katrina distribution is a distribution from a qualified retirement plan, 403(b) annuity, or IRA made on or after August 25, 2005 and before January 1, 2007 to an individual whose principal place of abode on August 28, 2005 was located in the Hurricane Katrina disaster area and who had sustained an economic loss as a result of the hurricane. The total amount of qualified Hurricane Katrina distributions that an individual can receive from all qualified retirement plans, tax-sheltered annuities, or IRAs is $100,000. Any amount required to be included in income as a result of a qualified Hurricane Katrina distribution may be included in income ratably over the three-year period beginning with the year of distribution. In addition, any portion of a qualified Hurricane Katrina distribution repaid to a qualified retirement plan, tax-sheltered annuity or IRA within three years after the initial distribution is treated as a rollover and thereby excluded from the taxpayer's gross income and exempt from the 10-percent early withdrawal tax.

Provide tax-favored and penalty-free treatment for the recontribution of withdrawals for home purchase cancelled as a result of Hurricane Katrina.—Under current law, certain amounts held in a 401(k) plan or a 403(b) annuity may not be distributed before severance from employment, age 59½, death, disability, or financial hardship of the employee. For this purpose, subject to certain conditions, distributions for costs directly related to the purchase of a principal residence by an employee (excluding mortgage payments) are deemed to be distributions on account of financial hardship. Current law also allows distributions of up to $10,000 from IRAs for the purchase or construction of a principal residence of a first-time homebuyer. Under this Act, hardship distributions from a 401(k) plan or 403(b) annuity, and qualified first-time homebuyer distributions from an IRA received after February 28, 2005 and before August 29, 2005 for the purchase or construction of a principal residence in the Hurricane Katrina disaster area can be recontributed to such a plan, annuity or IRA if the residence was not purchased or constructed as a result of the hurricane. Any amount recontributed to such a plan is treated as a rollover and thereby excluded from the taxpayer's gross income and exempt from the 10-percent early withdrawal tax.

Modify treatment of loans from qualified retirement plans.—A loan from a qualified retirement plan to a plan participant generally is treated as a taxable distribution under current law. An exception to this general rule is provided to the extent that the loan does not exceed the lesser of (1) $50,000, reduced by the excess of the highest outstanding balance of loans from such plans during the one-year period ending on the day before the date the loan is made over the outstanding balance of loans from the plan on the date the loan is made, or (2) the greater of $10,000 or one half of the participant's accrued benefit under the plan. This Act increased from $50,000 to $100,000 the limit on loans from a qualified retirement plan to an individual whose principal place of abode on August 28, 2005 was located in the Hurricane Katrina disaster area and who sustained an economic loss as a result of Hurricane Katrina. To qualify for the higher limit, the loan must be made after September 23, 2005 and before January 1, 2007.

GULF OPPORTUNITY ZONE ACT OF 2005

This Act, which was signed by President Bush on December 21, 2005, created a Gulf Opportunity Zone (GO Zone), in which additional tax relief was provided to individuals and businesses affected by Hurricane Katrina. This Act also extended many of the tax benefits provided in the Katrina Emergency Tax Relief Act of 2005 to victims of Hurricane Rita and Hurricane Wilma. For purposes of this Act, the "Hurricane Rita disaster area" is that area with respect to which a major disaster was declared by President Bush before October 6, 2005 by reason of Hurricane Rita and the "Hurricane Wilma disaster area" is that area with respect to which a major disaster was declared by President Bush before November 14, 2005 by reason of Hurricane Wilma. The "Gulf Opportunity Zone," "Rita GO Zone," and "Wilma GO Zone," are defined, respectively, as that portion of the Hurricane Katrina, Rita and Wilma disaster areas determined by the President to warrant individual or individual and public assistance. The major provisions of this Act are described below.

Tax Relief for the Gulf Opportunity Zone

Provide tax-exempt bond financing.—Interest on bonds issued by State and local governments to finance activities carried out and paid for by private persons (private activity bonds) is taxable unless the activities are specified in the Internal Revenue Code. The volume of certain tax-exempt private activity bonds that State and local governments may issue in each calendar year is limited by State-wide volume limits. Under this Act, Alabama, Louisiana, and Mississippi (or any political subdivision thereof) were provided authority to issue tax-exempt private activity bonds for: (1) the cost of any qualified rental project in the Gulf Opportunity Zone (GO Zone); (2) the cost of acquisition, construction, reconstruction, and renovation of nonresidential real property and public utility property in the GO Zone; and (3) the cost of certain owner-occupied residences in the GO Zone. Authority to issue these bonds, which are not subject to the aggregate annual State private activity bond volume limit, expires after December 31, 2010. The maximum aggregate amount of bonds issued in each State is limited to $2,500 multiplied by the population of the State within the GO Zone. Depending on the purpose for which such bonds are issued, they are treated as either exempt facility bonds or qualified mortgage bonds and are subject to the general rules applicable to the issuance of such bonds, except as modified by this Act.

Allow advance refunding of certain tax-exempt bonds.—Refunding bonds are used to pay principal, interest or redemption price on previously issued bonds. Different rules apply to "current" and "advance" refunding bonds. A current refunding occurs when the refunded debt is retired within 90 days of issuance of the refunding bonds. Tax-exempt bonds may be currently refunded an indefinite number of times. An advance refunding occurs when the refunded debt is not retired within 90 days after the refunding bonds are issued; instead, the proceeds of the refunding bonds are invested in an escrow account and held until a future date when the refunded debt may be retired. In general, governmental bonds and tax-exempt private activity bonds for charitable organizations (qualified 501(c)(3) bonds) may be advance refunded one time.

This Act permitted an additional advance refunding of certain governmental and qualified 501(c)(3) bonds issued by Alabama, Louisiana, or Mississippi (or any political subdivision thereof). It also permitted one advance refunding of certain exempt facility bonds for airports, docks, or wharves issued by these States or any political subdivision thereof. Eligible bonds include only those bonds outstanding on August 28, 2005 that could not be advance refunded because of restrictions in effect on that date. The maximum amount of advance refunding bonds that may be issued under this provision by Louisiana, Mississippi and Alabama is $4.5 billion, $2.250 billion, and $1.125 billion, respectively. Eligible advance refunding bonds must be designated as such by the governor of the respective State and must be issued before January 1, 2011.

Increase and modify the low-income housing tax credit.—A low-income housing tax credit is provided to owners of qualified low-income rental units under current law. The credit may be claimed over a 10-year period for a portion of the cost of rental housing occupied by tenants having incomes below specified levels. The credit percentage for newly constructed or substantially rehabilitated housing that is not federally subsidized is adjusted monthly by the IRS so that the 10 annual credit amounts have a present value of 70 percent of the qualified basis of the structure. The credit percentage for newly constructed or substantially rehabilitated housing that is federally subsidized is calculated to have a present value of 30 percent of the qualified basis of the structure. Buildings located in high cost areas (qualified census tracts and difficult development areas) are eligible for an enhanced credit, provided no more than 20 percent of the population of each metropolitan statistical area or nonmetropolitan statistical area is a difficult development area. Under the enhanced credit, the 70 percent and 30 percent credits are increased to 91 percent and 39 percent, respectively. The aggregate credit authority allocated to each State for calendar year 2006 generally is the greater of $2.180 million or $1.90 per capita. These amounts are indexed annually for inflation. In general, to qualify for the credit, a low-income housing project must satisfy one of two tests: (1) 20 percent or more of the residential units in the project are both rent-restricted and occupied by individuals whose income is 50 percent or less of area median gross income; or (2) 40 percent or more of the residential units in the project are both rent-restricted and occupied by individuals whose income is 60 percent or less of area median gross income.

Under this Act, for calendar years 2006 through 2008, the otherwise applicable aggregate housing credit authority was increased for each State within the GO Zone. The additional credit amount for each State is equal to $18.00 multiplied by the number of such State's residents within the GO Zone. This amount is not indexed for inflation. For calendar year 2006, the otherwise applicable aggregate housing credit authority amount for both Florida and Texas was increased by $3.5 million. This Act also replaced the area median gross income standards of current law with a national nonmetropolitan median gross income standard, with respect to property placed in service in a nonmetropolitan area within the GO Zone during calendar years 2006, 2007, and 2008. The income targeting rules for property in metropolitan areas in the Go Zone are the same as under current law. In addition, property placed in service in calendar years 2006 through 2008 in the Go Zone, the Rita Go Zone, and the Wilma GO Zone are treated as high-cost areas and eligible for the enhanced credit; the 20 percent of population restriction of current law is waived. The enhanced credit and modified income targeting rules apply regardless of whether the property receives its credit allocation under the otherwise applicable low-income housing authority or the additional credit authority provided in this Act.

Provide special depreciation allowance for certain property.—Taxpayers are allowed to recover the cost of certain property used in a trade or business or for the production of income through annual depreciation deductions. The amount of the allowable depreciation deduction for a taxable year generally is determined under MACRS, which assigns applicable recovery periods and depreciation methods to different types of property. Under this Act, qualifying GO Zone property is eligible for an additional first-year depreciation deduction equal to 50 percent of the adjusted basis of the property. The additional first-year deprecation deduction is allowed for both regular and alternative minimum tax purposes in the year the property is placed in service. The basis of the property and the depreciation deductions allowable in other years are adjusted to reflect the additional first-year depreciation deduction. Qualifying property generally must be tangible property with a recovery period of 20 years or less, and also includes: (1) certain computer software; (2) water utility property; (3) leasehold improvement property; (4) nonresidential real property; and (5) residential rental property. In addition: (1) substantially all of the use of the property must be in the GO Zone and in the active conduct of a trade or business by the taxpayer in the GO Zone; (2) the original use of the property in the Go Zone must commence with the taxpayer on or after August 28, 2005; and (3) the property must be acquired by purchase by the taxpayer on or after August 28, 2005 and placed in service on or before December 31, 2007 (December 31, 2008 in the case of nonresidential real property and residential rental property). Property acquired under a binding written contract entered into before August 28, 2005 is not eligible for the additional first-year depreciation deduction provided under this provision. Current law allowed certain property an extended placed-in-service deadline (December 31, 2005) with respect to existing additional first-year depreciation provisions. This Act granted the Department of Treasury authority to extend that deadline for up to one year if such property is placed in service in the GO Zone, the Rita GO Zone or the Wilma GO Zone.

Increase expensing for small business.—Business taxpayers are allowed to expense up to $100,000 in annual investment expenditures for eligible property placed in service in taxable years 2003 through 2007. The amount that may be expensed is reduced by the amount by which the taxpayer's annual cost of qualifying property exceeds $400,000. Both the deduction and annual investment limits are indexed annually for inflation, effective for taxable years beginning after 2003 and before 2008. Eligible property includes tangible personal property, certain real property, and, currently, off-the-shelf computer software. This Act increased the amount of annual investment expenditures that business taxpayers are allowed to expense by the lesser of $100,000 or the cost of eligible property that is also qualified GO Zone property placed in service during the taxable year. This Act also increased the phase-out threshold investment amount by the lesser of $600,000 or the cost of eligible property that is also qualified GO Zone property placed in service during the taxable year. Neither of these increased values is indexed for inflation. Qualified GO Zone property is property that meets the requirements needed to qualify for the special depreciation allowance (see discussion in the preceding paragraph).

Allow five-year carryback of certain net operating losses.—A net operating loss (NOL) generally is the amount by which a taxpayer's allowable deductions exceed the taxpayer's gross income. A carryback of an NOL generally results in a refund of Federal income taxes paid for the carryback year. A carryforward of an NOL generally reduces Federal income tax payments for the carryforward year. Under current law, an NOL generally can be carried back two years and carried forward 20 years. This Act provided a special five-year carryback period for NOLs to the extent of certain specified amounts related to Hurricane Katrina or the GO Zone. The amount of the NOL eligible for the five-year carryback is limited to the aggregate amount of the following deductions: (1) qualified GO Zone casualty losses; (2) certain moving expenses; (3) certain temporary housing expenses; (4) depreciation deductions with respect to qualified GO Zone property for the taxable year the property is placed in service; and (5) deductions for certain repair expenses resulting form Hurricane Katrina. The five-year carryback applies to losses paid or incurred after August 27, 2005 and before January 1, 2008.

Increase amount of qualifying investment eligible for the new markets tax credit.—Under current law, the new markets tax credit is provided for qualified equity investments made to acquire stock in a corporation or a capital interest in a partnership that is a qualified community development entity (CDE). A credit of five percent is provided to the investor for the first three years of investment. The credit increases to six percent for the next four years. The maximum amount of annual qualifying equity investment is capped at $2.0 billion for calendar years 2004 and 2005, and $3.5 billion for calendar years 2006 and 2007. This Act increased the annual qualifying equity investment cap by $300 million for 2005 and 2006, and $400 million for 2007. The additional amount is to be allocated among qualified CDEs to make qualified low-income community investments within the GO Zone. To qualify for the allocation, a qualified CDE must have as a significant mission the recovery and redevelopment of the GO Zone.

Provide tax relief for in-kind lodging provided by an employer.—Under current law, employer-provided housing generally is includible in income as compensation and is wages for purposes of social security, Medicare, and unemployment insurance taxes. This Act provided an income tax exclusion for the value of in-kind lodging provided for a month to a qualified employee (and the employee's spouse or dependents) by or on behalf of a qualified employer. The amount of the exclusion for any month for which such lodging is furnished cannot exceed $600. For purposes of this exclusion, a qualified employee is any individual who: (1) on August 28, 2005, had a principal residence in the GO Zone; and (2) performed substantially all of his or her employment services in the Go Zone for the qualified employer furnishing the lodging. A qualified employer is any employer with a trade or business located in the GO Zone. The exclusion, which applies to lodging provided after December 31, 2005 and before July 1, 2006, does not apply for purposes of social security, Medicare or unemployment insurance taxes. This Act also provided a tax credit to qualified employers equal to 30 percent of the value of such lodging excluded from the income of a qualified employee. The amount taken as a credit is not deductible by the employer.

Provide other tax relief.—Other tax relief provided to property and individuals located in the GO Zone included: (1) a deduction for 50 percent of certain cleanup costs; (2) a two-year extension of the current law provision allow expensing of certain environmental remediation costs; (3) an increase in the rehabilitation tax credit with respect to certain buildings; (4) an increase in the expensing limit for reforestation expenditures of certain small timber producers (also applicable to the Rita and Wilma GO Zones); (5) a five-year carryback for certain timber losses (also applicable to the Rita and Wilma GO Zones); (6) a ten-year carryback for certain public utility casualty losses; (7) a new category of tax-credit bonds to be issued by Louisiana, Mississippi and Alabama; (8) modification of the treatment of public utility disaster losses; and (9) expansion of the Hope and Lifetime Learning credits.

Exclude certain property from specific tax benefits.—The provisions of this Act relating to additional first-year depreciation, increased expensing for small business, and the five-year carryback of NOLs do not apply with respect to the following property: (1) any private or commercial golf course, country club, massage parlor, hot tub facility, or suntan facility; (2) any store the principal business of which is the sale of alcoholic beverages for consumption off premises; and (3) any gambling or animal racing property.

Tax Relief for Victims of Hurricanes Rita and Wilma

Provide special rules for the use of retirement funds.—Under the Katrina Emergency Tax Relief Act of 2005, special rules were provided for the use of retirement funds by an individual whose principal place of abode on August 28, 2005 was located in the Hurricane Katrina disaster area and who had sustained an economic loss as a result of the hurricane. These special rules, which are described in greater detail under the discussion of the Katrina Emergency Tax Relief Act of 2005, included the following: (1) tax-favored and penalty-free withdrawals from retirement plans; (2) tax-favored and penalty-free treatment for the recontribution of withdrawals for home purchase cancelled as a result of the hurricane; and (3) modification of the treatment of loans from qualified plans. This Act expanded that relief to apply to: (1) an individual whose principal place of abode on September 23, 2005 was located in the Hurricane Rita disaster area and who sustained an economic loss as a result of the hurricane; and (2) an individual whose principal place of abode on October 23, 2005 was located in the Hurricane Wilma disaster area and who sustained an economic loss as a result of the hurricane.

Provide an employee retention credit to employers affected by Hurricanes Rita and Wilma.—Under the Katrina Emergency Tax Relief Act of 2005, an employee retention credit was provided to employers who employed an average of 200 or fewer employees in a business located in the core Katrina disaster area on August 28, 2005, whose business was inoperable on any day during the period August 28, 2005 through December 31, 2005, as a result of Hurricane Katrina. This Act repealed the employer size limitation, effective for wages paid with respect to Hurricane Katrina on any day after August 28, 2005 and before January 1, 2006. This Act also expanded eligibility for the employee retention credit, as modified to repeal the employer size limitation, to apply to employers affected by Hurricanes Rita and Wilma and located in the Rita GO Zone on September 23, 2005 and in the Wilma GO Zone on October 23, 2005, respectively.

Suspend limitation on charitable contributions.—Deductions for charitable contributions are subject to certain limitations under current law. The Katrina Emergency Tax Relief Act of 2005 temporarily suspended these limitations for corporations and individuals who itemize deductions with respect to cash contributions to certain public charities made after August 27, 2005 and before January 1, 2006. For corporations, the suspension applied only to contributions for relief efforts related to Hurricane Katrina. This Act expanded this temporary suspension to apply to corporate cash contributions for relief efforts related to Hurricanes Rita and Wilma.

Suspend limitation on personal casualty losses.—The Katrina Emergency Tax Relief Act of 2005 suspended both the $100 and 10-percent-of-AGI limitations otherwise applicable to personal casualty losses, with respect to such loses occurring in the Hurricane Katrina disaster area on or after August 25, 2005 and attributable to the hurricane. This Act expanded this suspension to apply to such losses occurring in the Hurricane Rita disaster area on or after September 23, 2005 and the Hurricane Wilma disaster area on or after October 23, 2005.

Provide other tax relief for victims of Hurricane Rita and Hurricane Wilma.—Other tax relief provided to victims of Hurricanes Rita and Wilma included: (1) a special rule for purposes of computing the refundable portion of the child tax credit and the EITC; (2) authority to make adjustments regarding taxpayer and dependency status; and (3) special rules for mortgage revenue bonds.

Other Provisions

Extend election to treat combat pay as earned income for purposes of computing the EITC.—This Act extended for one year, through December 31, 2006, the prior law election that allowed combat pay, which is otherwise excluded from gross income, to be treated as earned income for purposes of calculating the EITC.

Modify the rules regarding the suspension of interest and penalties where the IRS fails to contact the taxpayer.—In general, interest and penalties accrue during periods for which taxes are unpaid, without regard to whether the taxpayer was aware that taxes were due. Beginning 18 months after the filing of a timely return, the accrual of certain penalties and interest is suspended if the IRS failed to send the taxpayer a notice specifically stating the taxpayer's liability and the basis for the liability. Interest and penalties resume 21 days after the required notice is sent to the taxpayer by the IRS. The temporary suspension of certain penalties and interest does not apply to interest accruing after October 3, 2004 with respect to underpayments resulting from listed transactions or undisclosed reportable transactions. This Act expanded the exception for listed transactions and undisclosed reportable transactions to apply to interest accruing on or before October 3, 2004. However, taxpayers remain eligible for the present-law suspension of interest if: (1) the year in which the underpayment occurred is barred by the statute of limitations (or a closing agreement) as of December 14, 2005; (2) it is determined that the taxpayer acted reasonably and in good faith with respect to the transaction; or (3) as of January 23, 2006, the taxpayer participates in the IRS settlement initiative with respect to the transaction. In addition, if a taxpayer files an amended return or other signed written document after December 21, 2005 that shows that the taxpayer owes an additional amount of tax for a given taxable year, the 18-month period is measured from the latest date on which such documents were provided.

Make technical corrections to recently enacted legislation.—This Act also included technical corrections and other corrections to recently enacted tax legislation.

DOMINICAN REPUBLIC-CENTRAL AMERICA-UNITED STATES FREE TRADE AGREEMENT IMPLEMENTATION ACT

This Act, which was signed by President Bush on August 2, 2005, approved and provided for U.S implementation of the Dominican Republic-Central America-United States Free Trade Agreement, as signed by the United States, Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua and the Dominican Republic. When this Agreement enters into force, it will level the playing field for U.S. farmers, manufacturers and entrepreneurs. This Agreement will expand access for U.S. manufactured goods and agricultural products to a market of 44 million customers. In addition to advancing U.S. economic interests, this Agreement provides a unique opportunity to strengthen our political ties with Central America and the Caribbean, thereby enhancing our Nation's security as democracy, stability and prosperity advance throughout the region.

UNITED STATES-BAHRAIN FREE TRADE AGREEMENT IMPLEMENTATION ACT

This Act, which was signed by President Bush on January 11, 2006, approved and provided for U.S. implementation of the United States-Bahrain Free Trade Agreement, as signed by the United States and Bahrain on September 14, 2004. When this Agreement enters into force, it will provide increased access to Bahrain's markets for U.S. industrial, consumer, and agricultural goods, and create new opportunities for U.S. services firms. In addition to enhancing our bilateral relationship with a strategic friend and ally in the Middle East region and promoting economic growth and prosperity in both nations, this Agreement provides an important opportunity to encourage economic development in a moderate Muslim nation that is a leader of reform in the Gulf region. This Agreement marks a significant step in implementing the President's plan for a broader Middle East Free Trade Area.

ADMINISTRATION PROPOSALS

REFORM THE FEDERAL TAX SYSTEM

Americans deserve a tax system that is simple, fair, and pro-growth—in tune with our dynamic, 21st century economy. The tax system should allow taxpayers to make decisions based on economic merit, free of tax-induced distortions. The bipartisan and unanimous Report of the President's Advisory Panel on Federal Tax Reform has provided a strong foundation for a national discussion on ways to ensure that our tax system better meets the needs of today's economy.

The President has proposed several changes that move the tax code in this direction. The Budget includes proposals to make health care more affordable to a mobile labor force, to promote savings for all Americans, to encourage investment by entrepreneurs, and to enhance our competitiveness by lowering the cost of capital. The Budget also recognizes that tax policy analysis needs to account fully for the economic benefits of reform on our economy. In the coming months, the Treasury Department will continue to study reform and engage in a public dialogue on this important issue.

MAKE PERMANENT CERTAIN TAX CUTS ENACTED IN 2001 AND 2003

Extend permanently reductions in individual income taxes on capital gains and dividends.—The maximum individual income tax rate on net capital gains and dividends is 15 percent for taxpayers in individual income tax rate brackets above 15 percent and 5 percent (zero in 2008) for lower income taxpayers. The Administration proposes to extend permanently these reduced rates (15 percent and zero), which are scheduled to expire on December 31, 2008.

Extend permanently increased expensing for small business.—Business taxpayers are allowed to expense up to $100,000 in annual investment expenditures for qualifying property (expanded to include off-the-shelf computer software) placed in service in taxable years 2003 through 2007. The amount that may be expensed is reduced by the amount by which the taxpayer's cost of qualifying property exceeds $400,000. Both the deduction and annual investment limits are indexed annually for inflation, effective for taxable years beginning after 2003 and before 2008. Also, with respect to a taxable year beginning after 2002 and before 2008, taxpayers are permitted to make or revoke expensing elections on amended returns without the consent of the IRS Commissioner. The Administration proposes to extend permanently each of these temporary provisions, applicable for qualifying property (including off-the-shelf computer software) placed in service in taxable years beginning after 2007.

Extend permanently provisions expiring in 2010.—Most of the provisions of the 2001 tax cut sunset on December 31, 2010. The Administration proposes to extend those provisions permanently.

TAX INCENTIVES

Simplify and Encourage Saving

Expand tax-free savings opportunities.—Under current law, individuals can contribute to traditional Individual Retirement Accounts (IRAs), nondeductible IRAs, and Roth IRAs, each subject to different sets of rules. For example, contributions to traditional IRAs are deductible, while distributions are taxed; contributions to Roth IRAs are taxed, but distributions are excluded from income. In addition, eligibility to contribute is subject to various age and income limits. While primarily intended for retirement saving, withdrawals for certain education, medical, and other non-retirement expenses are penalty free. The eligibility and withdrawal restrictions for these accounts complicate compliance and limit incentives to save.

The Administration proposes to replace current law IRAs with two new savings accounts: a Lifetime Savings Account (LSA) and a Retirement Savings Account (RSA). Regardless of age or income, individuals could make annual nondeductible contributions of $5,000 to an LSA and $5,000 (or earnings if less) to an RSA. Distributions from an LSA would be excluded from income and could be made at anytime for any purpose without restriction. Distributions from an RSA would be excluded from income after attaining age 58 or in the event of death or disability. All other distributions would be included in income (to the extent they exceed basis) and subject to an additional tax. Distributions would be deemed to come from basis first. The proposal would be effective for contributions made after December 31, 2006 and future year contribution limits would be indexed for inflation.

Existing Roth IRAs would be renamed RSAs and would be subject to the new rules for RSAs. Existing traditional and nondeductible IRAs could be converted into an RSA by including the conversion amount (excluding basis) in gross income, similar to a current-law Roth conversion. However, no income limit would apply to the ability to convert. Taxpayers who convert IRAs to RSAs could spread the included conversion amount over several years. Existing traditional or nondeductible IRAs that are not converted to RSAs could not accept new contributions. New traditional IRAs could be created to accommodate rollovers from employer plans, but they could not accept new individual contributions. Individuals wishing to roll an amount directly from an employer plan to an RSA could do so by including the rollover amount (excluding basis) in gross income (i.e., "converting" the rollover, similar to a current law Roth conversion).

Saving will be further simplified and encouraged by administrative changes already planned for the 2007 filing season that will allow taxpayers to have their tax refunds directly deposited into more than one account. Consequently, taxpayers will be able, for example, to direct that a portion of their tax refunds be deposited into an LSA or RSA.

Consolidate employer-based savings accounts.—Current law provides multiple types of tax-preferred employer-based savings accounts to encourage saving for retirement. The accounts have similar goals but are subject to different sets of rules regulating eligibility, contribution limits, tax treatment, and withdrawal restrictions. For example, 401(k) plans for private employers, SIMPLE 401(k) plans for small employers, 403(b) plans for 501(c)(3) organizations and public schools, and 457 plans for State and local governments are all subject to different rules. To qualify for tax benefits, plans must satisfy multiple requirements. Among the requirements, the plan generally may not discriminate in favor of highly compensated employees with regard either to coverage or to amount or availability of contributions or benefits. Rules covering employer-based savings accounts are among the lengthiest and most complicated sections of the tax code and associated regulations. This complexity imposes substantial costs on employers, participants, and the Government, and likely has inhibited the adoption of retirement plans by employers, especially small employers.

The Administration proposes to consolidate 401(k), SIMPLE 401(k), 403(b), and 457 plans, as well as SIMPLE IRAs and SARSEPs, into a single type of plan—Employee Retirement Savings Accounts (ERSAs) that would be available to all employers. ERSA non-discrimination rules would be simpler and include a new ERSA non-discrimination safe-harbor. Under one of the safe-harbor options, a plan would satisfy the nondiscrimination rules with respect to employee deferrals and employee contributions if it provided a 50-percent match on elective contributions up to six percent of compensation. By creating a simplified and uniform set of rules, the proposal would substantially reduce complexity. The proposal would be effective for taxable years beginning after December 31, 2006.

Establish Individual Development Accounts (IDAs).—The Administration proposes to allow eligible individuals to make contributions to a new savings vehicle, the Individual Development Account, which would be set up and administered by qualified financial institutions, nonprofit organizations, or Indian tribes (qualified entities). Citizens or legal residents of the United States between the ages of 18 and 60 who cannot be claimed as a dependent on another taxpayer's return, are not students, and who meet certain income limitations would be eligible to establish and contribute to an IDA. A single taxpayer would be eligible to establish and contribute to an IDA if his or her modified AGI in the preceding taxable year did not exceed $20,000 ($30,000 for heads of household, and $40,000 for married taxpayers filing a joint return). These thresholds would be indexed annually for inflation beginning in 2008. Qualified entities that set up and administer IDAs would be required to match, dollar-for-dollar, the first $500 contributed by an eligible individual to an IDA in a taxable year. Qualified entities would be allowed a 100 percent tax credit for up to $500 in annual matching contributions to each IDA, and a $50 tax credit for each IDA maintained at the end of a taxable year with a balance of not less that $100 (excluding the taxable year in which the account was established). Matching contributions and the earnings on those contributions would be deposited in a separate "parallel account." Contributions to an IDA by an eligible individual would not be deductible, and earnings on those contributions would be included in income. Matching contributions by qualified entities and the earnings on those contributions would be tax-free.

Withdrawals from the parallel account may be made only for qualified purposes (higher education, the first-time purchase of a home, business start-up, and qualified rollovers). Withdrawals from the IDA for other than qualified purposes may result in the forfeiture of some or all matching contributions and the earnings on those contributions. The credit could be claimed for taxable years ending after December 31, 2007 and beginning before January 1, 2015. The credit would apply with respect to the first 900,000 IDA accounts opened after December 31, 2007 and before January 1, 2013, and with respect to matching funds for participant contributions that are made after December 31, 2007 and before January 1, 2015.

Encourage Entrepreneurship and Investment

Increase expensing for small business.—Business taxpayers are allowed to expense up to $100,000 in annual investment expenditures for qualifying property (expanded to include off-the-shelf computer software) placed in service in taxable years 2003 through 2007. The amount that may be expensed is reduced by the amount by which the taxpayer's cost of qualifying property exceeds $400,000. Both the deduction and annual investment limits are indexed annually for inflation, effective for taxable years beginning after 2003 and before 2008. Also, with respect to a taxable year beginning after 2002 and before 2008, taxpayers are permitted to make or revoke expensing elections on amended returns without the consent of the IRS Commissioner. The Administration proposes to increase the amount of annual investment expenditures that taxpayers are allowed to expense to $200,000, and to raise the amount of qualifying investment at which the phase-out begins to $800,000, effective for qualifying property placed in service in taxable years beginning after 2006. These higher amounts would be indexed for inflation, effective for taxable years beginning after 2007.

Invest in Health Care

Expand health savings accounts (HSAs).—Current law provides a tax preference for employer-provided group health insurance plans, but not for individually purchased health insurance coverage except to the extent that deductible medical expenses exceed 7.5 percent of AGI, the individual has self-employment income, or the individual is eligible under the Trade Act of 2002 to purchase certain types of qualified health insurance. In addition, individuals are allowed to accumulate funds in a health savings account (HSA) or medical savings account (MSA) on a tax-preferred basis to pay for medical expenses, provided they are covered by an HSA-qualified high-deductible health plan (HDHP), and no other health plan. Under current law, only employer contributions to HSAs are excluded from income for payroll tax purposes.

The Administration proposes that individuals who make after-tax contributions to an HSA would be allowed a credit equal to a percentage of their after-tax contributions to the HSA to offset the employment taxes on their contributions. The credit generally would be 15.3 percent of their HSA contributions, but would be limited by the amount of wages in the payroll tax base. In order to recapture the credit relating to employment taxes for contributions that are not used for medical expenses, the additional tax on non-medical withdrawals would increase to 30 percent, with a 15 percent rate on non-medical distributions after death, disability, or attaining the age of 65.

The Administration proposes to increase the maximum HSA contribution for all eligible individuals. For any year, the maximum HSA contribution would be increased to the bona fide out-of-pocket limit of the high-deductible health plan.

Additional changes would be made to HSAs to encourage the use of HSAs and coverage under the HSA-eligible high-deductible health plans, including: (1) allowing HSA funds to be used tax-free for premiums for the purchase of non-group high-deductible health plans; (2) allowing qualified medical expenses to include any medical expense incurred on or after the first day of HDHP coverage if individuals have established an HSA by their return filing date for that year; (3) allowing employers to contribute existing health reimbursement arrangement (HRA) balances to the HSAs of employees who would be eligible individuals but for the HRA coverage; and (4) excluding from the comparability rules extra employer contributions to HSAs on behalf of employees who are chronically ill or employees who have spouses or dependents who are chronically ill. All of the HSA-related proposals would be effective for years beginning after December 31, 2006.

Provide an above-the-line deduction for high-deductible insurance premiums.—Current law provides a tax preference for employer-provided group health insurance plans, but not for individually purchased health insurance coverage except to the extent that deductible medical expenses exceed 7.5 percent of AGI, the individual has self-employment income, or the individual is eligible under the Trade Act of 2002 to purchase certain types of qualified health insurance. Current law also allows individuals to accumulate funds in an HSA or MSA on a tax-preferred basis to pay for medical expenses, provided they are covered by an HDHP, and no other health plan.

The Administration proposes to allow individuals who are eligible for an HSA because they are covered under an HDHP in the individual insurance market to deduct the amount of the premium in determining AGI (whether or not the person itemizes deductions). These individuals would also be entitled to an income tax credit to account for employment taxes. Individuals claiming other credits or deductions or covered by public plans or otherwise not eligible to contribute to an HSA would not qualify for the above-the-line deduction or the credit. The credit generally would be 15.3 percent of their HDHP premium payment, but would be limited by the amount of wages in the payroll tax base. The above-the-line deduction and tax credit would be effective for taxable years beginning after December 31, 2006.

Provide refundable tax credit for the purchase of health insurance.—Current law provides a tax preference for employer-provided group health insurance plans, but not for individually purchase health insurance coverage except to the extent that deductible medical expenses exceed 7.5 percent of AGI, the individual has self-employment income, or the individual is eligible under the Trade Act of 2002 to purchase certain types of qualified health insurance. In addition, individuals are allowed to accumulate funds in an HSA or MSA on a tax-preferred basis to pay for medical expenses, provided they are covered by an HDHP, and no other health plan.

The Administration proposes to make health insurance more affordable for individuals not covered by an employer plan or a public program. Effective for taxable years beginning after December 31, 2006, a new refundable tax credit would be provided for the cost of an HDHP purchased by an individual under age 65. The credit would provide a subsidy for a percentage of the health insurance premium, up to a maximum includable premium. The maximum subsidy percentage would be 90 percent for low-income taxpayers and would phase down with income. The maximum credit would be $1,000 for a plan covering one adult, $2,000 for a plan covering two adults, $3,000 for a plan covering two adults and one or more children, and $1,000 for a plan covering only children. The credit would be phased out at an income of $30,000 for single taxpayers and $60,000 for families purchasing a family policy. Individuals could claim the tax credit for health insurance premiums paid as part of the normal tax-filing process. Alternatively, beginning July 1, 2007, the tax credit would be available in advance at the time the individual purchases health insurance. The advance credit would reduce the premium paid by the individual to the health insurer, and the health insurer would be reimbursed directly by the Department of Treasury for the amount of the advance credit. Eligibility for an advance credit would be based on an individual's prior year tax return. Qualifying insurance could be purchased in the individual market. Qualifying health insurance could also be purchased through private purchasing groups, State-sponsored insurance purchasing pools, and high-risk pools.

Improve the Health Coverage Tax Credit.—The Health Coverage Tax Credit (HCTC) was created under the Trade Act of 2002 for the purchase of qualified health insurance. Eligible persons include certain individuals who are receiving benefits under the TAA or the Alternative TAA (ATAA) program and certain individuals between the ages of 55 and 64 who are receiving pension benefits from the Pension Benefit Guaranty Corporation (PBGC). The tax credit is refundable and can be claimed through an advance payment mechanism at the time the insurance is purchased.

To make the requirements for qualified State-based coverage under the HCTC more consistent with the rules applicable under the Health Insurance Portability and Accountability Act (HIPAA) and thus encourage more plans to participate in the HCTC program, the Administration proposes to allow State-based coverage to impose a pre-existing condition restriction for a period of up to 12 months, provided the plan reduces the restriction period by the length of the eligible individual's creditable coverage (as of the date the individual applied for the State-based coverage). This provision would be effective for eligible individuals applying for coverage after December 31, 2006. Also, in order to prevent an individual from losing the benefit of the HCTC just because his or her spouse becomes eligible for Medicare, the Administration proposes to permit spouses of HCTC-eligible individuals to claim the HCTC when the HCTC-eligible individual becomes entitled to Medicare coverage. The spouse, however, would have to be at least 55 years old and meet the other HCTC eligibility requirements. This provision would be effective for taxable years beginning after December 31, 2006.

To improve the administration of the HCTC, the Administration proposes to: (1) modify the definition of "other specified coverage" for "eligible ATAA recipients," to be the same as the definition applied to "eligible TAA recipients;" (2) clarify that certain PBGC pension recipients are eligible for the tax credit; (3) allow State-based continuation coverage to qualify without meeting the requirements for State-based qualified coverage; and (4) for purposes of the State-based coverage rules, permit the Commonwealths of Puerto Rico and Northern Mariana Islands, as well as American Samoa, Guam, and the U.S. Virgin Islands to be deemed as States.

Allow the orphan drug tax credit for certain pre-designation expenses.—Current law provides a 50-percent credit for expenses related to human clinical testing of drugs for the treatment of certain rare diseases and conditions ("orphan drugs"). A taxpayer may claim the credit only for expenses incurred after the Food and Drug Administration (FDA) designates a drug as a potential treatment for a rare disease or condition. This creates an incentive to defer clinical testing for orphan drugs until the taxpayer receives the FDA's approval and increases complexity for taxpayers by treating pre-designation and post-designation clinical expenses differently. The Administration proposes to allow taxpayers to claim the orphan drug credit for expenses incurred prior to FDA designation if designation occurs before the due date (including extensions) for filing the tax return for the year in which the FDA application was filed. The proposal would be effective for qualified expenses incurred after December 31, 2005.

Provide Incentives for Charitable Giving

Permit tax-free withdrawals from IRAs for charitable contributions.—Under current law, eligible individuals may make deductible or non-deductible contributions to a traditional IRA. Pre-tax contributions and earnings in a traditional IRA are included in income when withdrawn. Effective for distributions after date of enactment, the Administration proposes to allow individuals who have attained age 65 to exclude from gross income IRA distributions made directly to a charitable organization. The exclusion would apply without regard to the percentage-of-AGI limitations that apply to deductible charitable contributions. The exclusion would apply only to the extent the individual receives no return benefit in exchange for the transfer, and no charitable deduction would be allowed with respect to any amount that is excludable from income under this provision.

Expand and increase the enhanced charitable deduction for contributions of food inventory.—A taxpayer's deduction for charitable contributions of inventory generally is limited to the taxpayer's basis (typically cost) in the inventory. However, for certain contributions of inventory, C corporations may claim an enhanced deduction equal to the lesser of: (1) basis plus one half of the fair market value in excess of basis, or (2) two times basis. To be eligible for the enhanced deduction, the contributed property generally must be inventory of the taxpayer contributed to a charitable organization and the donee must: (1) use the property consistent with the donee's exempt purpose solely for the care of the ill, the needy, or infants; (2) not transfer the property in exchange for money, other property, or services; and (3) provide the taxpayer a written statement that the donee's use of the property will be consistent with such requirements. To use the enhanced deduction, the taxpayer must establish that the fair market value of the donated item exceeds basis.

Under the Administration's proposal, which is designed to encourage contributions of food inventory to charitable organizations, any taxpayer engaged in a trade or business would be eligible to claim an enhanced deduction for donations of food inventory. The enhanced deduction for donations of food inventory would be increased to the lesser of: (1) fair market value or (2) two times basis. However, to ensure consistent treatment of all businesses claiming an enhanced deduction for donations of food inventory, the enhanced deduction for qualified food donations by S corporations and non-corporate taxpayers would be limited to 10 percent of net income from the trade or business. A special provision would allow taxpayers with a zero or low basis in the qualified food donation (e.g., taxpayers that use the cash method of accounting for purchases and sales, and taxpayers that are not required to capitalize indirect costs) to assume a basis equal to 25 percent of fair market value. The enhanced deduction would be available only for donations of "apparently wholesome food" (food intended for human consumption that meets all quality and labeling standards imposed by Federal, State, and local laws and regulations, even though the food may not be readily marketable due to appearance, age, freshness, grade, size, surplus, or other conditions). The fair market value of "apparently wholesome food" that cannot or will not be sold solely due to internal standards of the taxpayer or lack of market, would be determined by taking into account the price at which the same or substantially the same food items (as to both type and quality) are sold by the taxpayer at the time of the contribution or, if not sold at such time, in the recent past. These proposed changes in the enhanced deduction for donations of food inventory would be effective for taxable years beginning after December 31, 2005.

Reform excise tax based on investment income of private foundations.—Under current law, private foundations that are exempt from Federal income tax are subject to a two-percent excise tax on their net investment income (one-percent if certain requirements are met). The excise tax on private foundations that are not exempt from Federal income tax, such as certain charitable trusts, is equal to the excess of the sum of the excise tax that would have been imposed if the foundation were tax exempt and the amount of the unrelated business income tax that would have been imposed if the foundation were tax exempt, over the income tax imposed on the foundation. To encourage increased charitable activity and simplify the tax laws, the Administration proposes to replace the two rates of tax on the net investment income of private foundations that are exempt from Federal income tax with a single tax rate of one percent. The excise tax on private foundations not exempt from Federal income tax would be equal to the excess of the sum of the one-percent excise tax that would have been imposed if the foundation were tax exempt and the amount of the unrelated business income tax what would have been imposed if the foundation were tax exempt, over the income tax imposed on the foundation. The proposed change would be effective for taxable years beginning after December 31, 2005.

Modify tax on unrelated business taxable income of charitable remainder trusts.—A charitable remainder annuity trust is a trust that is required to pay, at least annually, a fixed dollar amount of at least five percent of the initial value of the trust to a non-charity for the life of an individual or for a period of 20 years or less, with the remainder passing to charity. A charitable remainder unitrust is a trust that generally is required to pay, at least annually, a fixed percentage of at least five percent of the fair market value of the trust's assets determined at least annually to a non-charity for the life of an individual or for a period of 20 years or less, with the remainder passing to charity. A trust does not qualify as a charitable remainder annuity trust if the annuity for a year is greater than 50 percent of the initial fair market value of the trust's assets. A trust does not qualify as a charitable remainder unitrust if the percentage of assets that are required to be distributed at least annually is greater than 50 percent. A trust does not qualify as a charitable remainder annuity trust or a charitable remainder unitrust unless the value of the remainder interest in the trust is at least 10 percent of the value of the assets contributed to the trust. Distributions from a charitable remainder annuity trust or charitable remainder unitrust, which are included in the income of the beneficiary for the year that the amount is required to be distributed, are treated in the following order as: (1) ordinary income to the extent of the trust's undistributed ordinary income for that year and all prior years; (2) capital gains to the extent of the trust's undistributed capital gain for that year and all prior years; (3) other income to the extent of the trust's undistributed other income for that year and all prior years; and (4) corpus (trust principal).

Charitable remainder annuity trusts and charitable remainder unitrusts are exempt from Federal income tax; however, such trusts lose their income tax exemption for any year in which they have unrelated business taxable income. Any taxes imposed on the trust are required to be allocated to trust corpus. The Administration proposes to levy a 100-percent excise tax on the unrelated business taxable income of charitable remainder trusts, in lieu of removing the Federal income tax exemption for any year in which unrelated business taxable income is incurred. This change, which is a more appropriate remedy than loss of tax exemption, is proposed to become effective for taxable years beginning after December 31, 2005, regardless of when the trust was created.

Modify basis adjustment to stock of S corporations contributing appreciated property.—Under current law, each shareholder in an S corporation separately accounts for his or her pro rata share of the S corporation's charitable contributions in determining his or her income tax liability. A shareholder's basis in the stock of the S corporation must be reduced by the amount of his or her pro rata share of the S corporation's charitable contribution. In order to preserve the benefit of providing a charitable contribution deduction for contributions of appreciated property and to prevent the recognition of gain in the contributed property on the disposition of the S corporation stock, the Administration proposes to allow a shareholder in an S corporation to increase his or her basis in the stock of an S corporation by an amount equal to the excess of the shareholder's pro rata share of the S corporation's charitable contribution over the stockholder's pro rata share of the adjusted basis of the contributed property. The proposal would be effective for taxable years beginning after December 31, 2005.

Repeal the $150 million limitation on qualified 501(c)(3) bonds.—Current law contains a $150 million limitation on the volume of outstanding, non-hospital, tax-exempt bonds for the benefit of any one 501(c)(3) organization. The limitation was repealed in 1997 for bonds issued after August 5, 1997, at least 95 percent of the net proceeds of which are used to finance capital expenditures incurred after that date. However, the limitation continues to apply to bonds more than five percent of the net proceeds of which finance or refinance working capital expenditures, or capital expenditures incurred on or before August 5, 1997. In order to simplify the tax laws and provide consistent treatment of bonds for 501(c)(3) organizations, the Administration proposes to repeal the $150 million limitation in its entirety.

Repeal certain restrictions on the use of qualified 501(c)(3) bonds for residential rental property.—Tax-exempt, 501(c)(3) organizations generally may utilize tax-exempt financing for charitable purposes. However, existing law contains a special limitation under which 501(c)(3) organizations may not use tax-exempt financing to acquire existing residential rental property for charitable purposes unless the property is rented to low-income tenants or is substantially rehabilitated. In order to simplify the tax laws and provide consistent treatment of bonds for 501(c)(3) organizations, the Administration proposes to repeal the residential rental property limitation.

Strengthen Education

Extend the above-the-line deduction for qualified out-of-pocket classroom expenses.—Under current law, teachers who itemize deductions (do not use the standard deduction) and incur unreimbursed, job-related expenses are allowed to deduct those expenses to the extent that when combined with other miscellaneous itemized deductions they exceeded two percent of AGI. Current law also allows certain teachers and other elementary and secondary school professionals to treat up to $250 in annual qualified out-of-pocket classroom expenses as a non-itemized deduction (above-the-line deduction). This additional deduction is effective for expenses incurred in taxable years beginning after December 31, 2001 and before January 1, 2006. Unreimbursed expenditures for certain books, supplies, and equipment related to classroom instruction qualify for the above-the-line deduction. Expenses claimed as an above-the-line deduction may not be claimed as an itemized deduction. The Administration proposes to extend the above-the-line deduction to apply to qualified out-of-pocket expenditures incurred in taxable years beginning after December 31, 2005.

Provide Assistance to Distressed Areas

Establish Opportunity Zones.—The Administration proposes to establish authority to designate 20 opportunity zones (14 in urban areas and 6 in rural areas). The zone designation and corresponding incentives would be in effect from January 1, 2007 through December 31, 2016. To qualify to apply for zone status, a community must either have suffered from a significant decline in its economic base over the past decade as measured by the loss of manufacturing and retail establishments and manufacturing jobs, or be a previously designated empowerment zone, renewal community or enterprise community. The Secretary of Commerce would select opportunity zones through a competitive process based on the applicant's "community transition plan" and "statement of economic transition." The community transition plan would have to set concrete, measurable goals for reducing local regulatory and tax barriers to construction, residential development and business creation. The statement of economic transition would have to demonstrate that the local community's economic base is in transition, as indicated by a declining job base and labor force, and other measures, during the past decade. In evaluating applications, the Secretary of Commerce could consider other factors, including: (1) changes in unemployment rates, poverty rates, household income, homeownership and labor force participation; (2) the educational attainment and average age of the population; and (3) for urban areas, the number of mass layoffs occurring in the area's vicinity over the previous decade. Empowerment zones and renewal communities designated as opportunity zones would not count against the limitation of 20 new opportunity zones. Such communities would be required to relinquish their current status and benefits once selected. Opportunity zone benefits for converted empowerment zones and renewal communities would expire on December 31, 2010. Tax benefits for enterprise communities expired at the end of 2004. Enterprise communities designated as opportunity zones would count against the limitation of 20 new zones and opportunity zone benefits would be in effect through 2016.

A number of tax incentives would be applicable to opportunity zones. First, a business would be allowed to exclude 25 percent of its taxable income if it qualified as an "opportunity zone business" and it satisfied a $5 million gross receipts test. The definition of an opportunity zone business would be based on the definition of a "qualified active low-income community business" for purposes of the new markets tax credit, treating opportunity zones as low-income communities. Second, an opportunity zone business would be allowed to expense the cost of section 179 property that is qualified zone property, up to an additional $100,000 above the amounts generally available under current law. Third, a commercial revitalization deduction would be available for opportunity zones in a manner similar to the deduction for renewal communities. A $12 million annual cap on these deductions would apply to each opportunity zone. Finally, individuals who live and work in an opportunity zone would constitute a new target group with respect to wages earned within the zone under the proposed combined work opportunity tax credit and welfare-to-work tax credit (see discussion later in this Chapter).

Protect the Environment

Extend permanently expensing of brownfields remediation costs.—Taxpayers may elect, with respect to expenditures paid or incurred before January 1, 2006, to treat certain environmental remediation expenditures that would otherwise be chargeable to a capital account as deductible in the year paid or incurred. The Administration proposes to extend this provision permanently making it available for expenditures paid or incurred after December 31, 2005, and facilitating its use by businesses to undertake projects that may be uncertain in overall duration.

Restructure Assistance to New York City

Provide tax incentives for transportation infrastructure.—The Administration proposes to restructure the tax benefits for New York recovery that were enacted in 2002. Some of the tax benefits that were provided to New York following the attacks of September 11, 2001, likely will not be usable in the form in which they were originally provided. As such, the Administration proposed in the Mid-Session Review of the 2005 Budget to sunset certain existing New York Liberty Zone tax benefits and in their place provide tax credits to New York State and New York City for expenditures incurred in building or improving transportation infrastructure in or connecting with the New York Liberty Zone. The tax credit would be available as of the date of enactment, subject to an annual limit of $200 million ($2 billion in total over 10 years), evenly divided between the State and the City. Any unused credit limit in a given year would be added to the $200 million allowable in the following year, including years beyond the 10-year period of the credit. Similarly, expenditures that could not be credited in a given year because of the credit limit would be carried forward and used against the next year's limitation. The credit would be allowed against any payments (e.g., income tax withholding) made by the City and State under any provision of the Internal Revenue Code, other than Social Security and Medicare payroll taxes and excise taxes. The Secretary of the Treasury may prescribe such rules as are necessary to ensure that the expenditures are made for the intended purpose.

Repeal certain New York City Liberty Zone incentives.—The Administration proposes to terminate the following tax incentives provided to qualified property within the New York Liberty Zone under the 2002 economic stimulus act: (1) the additional first-year depreciation deduction; (2) the five-year recovery period for leasehold improvement property; (3) increased expensing for small businesses; and (4) the extended replacement period for the nonrecognition of gain on involuntarily converted property. These terminations are proposed to be effective on the date of enactment. Property placed in service after the date of enactment would not be eligible for the first three incentives listed above unless a binding written contract was in effect on the date of enactment, in which case the property would need to be placed in service by the original termination dates provided in the 2002 economic stimulus act. Other related changes to the Internal Revenue Code would be made as appropriate.

SIMPLIFY THE TAX LAWS FOR FAMILIES

Clarify uniform definition of a child.—The 2004 tax relief act created a uniform definition of a child, allowing, in many circumstances, a taxpayer to claim the same child for five different child-related tax benefits. Under the new rules, a qualifying child must meet relationship, residency, and age tests. While the new rules simplify the determination of eligibility for many child-related tax benefits, the elimination of certain complicated factual tests to determine if siblings and certain other family members are eligible to claim a qualifying child may have some unintended consequences. The new rules effectively deny the EITC to some young taxpayers who are the sole guardians of their younger siblings. Yet some taxpayers are able to avoid income limitations on child-related tax benefits by allowing other family members, who have lower incomes, to claim the taxpayers' sons or daughters as qualifying children. The 2004 tax relief act had other unintended consequences, which made some of the eligibility rules less uniform. For example, it allowed dependent filers to claim the child tax credit, even though they are generally ineligible for most other child-related tax benefits. It also allowed taxpayers to claim the child tax credit on behalf of a married child who files a joint return with his or her spouse, even though the taxpayer generally cannot claim other benefits for the married child. These exceptions create confusion and add complexity.

To ensure that deserving taxpayers receive child-related tax benefits, the Administration proposes to clarify the uniform definition of a child. First, the definition of a qualifying child would be further simplified. A taxpayer would not be a qualifying child of another individual if the taxpayer is older than that individual. However, an individual could be a qualifying child of a younger sibling if the individual is permanently and totally disabled. Also, under the proposal, an individual who is married and filing jointly (for any reason other than to obtain a refund of overwithheld taxes) would not be considered a qualifying child for the child-related tax benefits, including the child tax credit. Second, the proposal clarifies when a taxpayer is eligible to claim child-related tax benefits. If a parent resides with his or her child for over half the year, the parent would be the only individual eligible to claim the child as a qualifying child. The parent could waive the child-related tax benefits to another member of the household who has higher adjusted gross income and is otherwise eligible for the tax benefits. In addition, dependent filers would not be allowed to claim qualifying children. The proposal is effective for taxable years beginning after December 31, 2006.

Simplify EITC eligibility requirement regarding filing status, presence of children, and work and immigrant status.—To qualify for the EITC, taxpayers must satisfy requirements regarding filing status, the presence of children in their households, and their work and immigration status in the United States. These rules are confusing, require significant record-keeping, and are costly to administer. Under the proposal, married taxpayers who reside with children could claim the EITC without satisfying a complicated household maintenance test if they live apart from their spouse for the last six months of the year. In addition, certain taxpayers who live with children but do not qualify for the larger child-related EITC could claim the smaller EITC for very low-income childless workers. The proposal would also improve the administration of the EITC with respect to eligibility requirements for undocumented workers. The proposal is effective for taxable years beginning after December 31, 2006.

Reduce computational complexity of refundable child tax credit.—Taxpayers with earned income in excess of $11,300 may qualify for a refundable (or "additional") child tax credit even if they do not have any income tax liability. About 70 percent of additional child tax credit claimants also claim the EITC. However, the two credits have a different definition of earned income and different U.S. residency requirements. In addition, some taxpayers have to perform multiple computations to determine the amount of the additional child tax credit they can claim. First, they must compute the additional child tax credit using a formula based on earned income. Then, if they have three or more children, they may recalculate the credit using a formula based on social security taxes and claim the higher of the two amounts.

Under the proposal, the additional child tax credit would use the same definition of earned income as is used for the EITC. Taxpayers (other than members of the Armed Forces stationed overseas) would be required to reside with a child in the United States to claim the additional child tax credit (as they are currently required to do for the EITC). Taxpayers with three or more children would do only one computation based on earned income to determine the credit amount. The proposal would be effective for taxable years beginning after December 31, 2006.

STRENGTHEN THE EMPLOYER-BASED PENSION SYSTEM

Ensure fair treatment of older workers in cash balance conversions and protect defined benefit plans.—Qualified retirement plans consist of defined benefit plans and defined contribution plans. In recent years, many plan sponsors have adopted cash balance and other "hybrid" plans that combine features of defined benefit and defined contribution plans. A cash balance plan is a defined benefit plan that provides for annual "pay credits" to a participant's "hypothetical account" and "interest credits" on the balance in the hypothetical account. Questions have been raised about whether such plans satisfy the rules relating to age discrimination and the calculation of lump sum distributions. The Administration proposes to: (1) ensure fairness for older workers in cash balance conversions; (2) protect the defined benefit system by clarifying the status of cash balance plans; and (3) remove the effective ceiling on interest credits in cash balance plans. All changes would be effective prospectively.

Strengthen funding for single-employer pension plans.—Under current law, defined benefit pension plans are subject to minimum funding requirements imposed under both the Internal Revenue Code and the Employee Retirement Income Security Act of 1974 (ERISA). In the case of a qualified plan, the Internal Revenue Code excludes such contributions from gross income and allows a deduction for the contributions, subject to certain limits on the maximum deductible amount. The calculation of the minimum funding requirements and the limits on deductible contributions are determined under a series of complex rules and measures of assets and liability, many of which are manipulable and none of which entail the use of an accurate measure of the plan's assets and its true liabilities.

The Administration proposes rationalizing the multiple sets of funding rules applicable to single-employer defined benefit plans and replacing them with a single set of rules that provide for: (1) funding targets that are based on meaningful, accurate measures of liabilities that reflect the financial health of the employer; (2) the use of market value of assets; (3) a seven-year amortization period for funding shortfalls; (4) the opportunity for an employer to make additional deductible contributions in good years, even when the plan's assets are above the funding target; and (5) meaningful consequences for employers and plans whose funded status does not improve.

These funding rules changes and the addition of meaningful consequences for employers and plans whose funded status does not improve and improved disclosure to plan participants, investors and regulators are part of an overall package of reforms that will improve the health of defined benefit pensions and the PBGC guarantee system. As described in Chapter 7 of Analytical Perspectives and the Department of Labor Chapter of the Budget volume, this overall package includes reform of the premium structure for the PBGC, revision in the application of the PBGC guarantee rates and changes to the bankruptcy law.

Reflect market interest rates in lump sum payments.—Current law generally requires that a lump sum paid from a pension plan be calculated using the rate of interest on 30-year Treasury securities (or a close proxy) for the month preceding the distribution. The Administration proposes that the value of the lump sum reflect market interest rates and the timing of the expected benefit payments for which the lump sum is calculated. This would ensure that the value of the lump sum is equivalent to the value of the annuity. Lump sums would be calculated using interest rates that are drawn from a zero-coupon corporate bond yield curve. The yield curve would be issued monthly by the Secretary of the Treasury and would be based on the interest rates (averaged over 90 business days) for high quality corporate bonds with varying maturities. In order to avoid disruptions, the proposal would be phased in for plan years beginning in 2008 and 2009 and would not be fully effective until the plan year beginning in 2010.

CLOSE LOOPHOLES AND IMPROVE TAX COMPLIANCE

Combat abusive foreign tax credit transactions.—Current law allows taxpayers a credit against U.S. taxes for foreign taxes incurred with respect to foreign income, subject to specified limits. The Administration proposes to provide the Department of Treasury with supplemental regulatory authority, in addition to its broad existing authority, to ensure that the foreign tax credit rules cannot be used to achieve inappropriate results that are not consistent with the underlying economics of the transactions in which the foreign tax credits arise. The regulatory authority would enhance the ability of the Department of Treasury to prevent the inappropriate separation of foreign taxes from the related foreign income. Regulations could provide for the disallowance of a credit for all or a portion of the foreign taxes or the reallocation of the foreign taxes among the participants to the transaction.

Modify the active trade or business test.—Current law allows corporations to avoid recognizing gain in certain spin-off and split-off transactions provided that, among other things, the active trade or business test is satisfied. The active trade or business test requires that immediately after the distribution, the distributing corporation and the corporation the stock of which is distributed (the controlled corporation) be engaged in a trade or business that has been actively conducted throughout the five-year period ending on the date of the distribution. There is no statutory requirement that a certain percentage of the distributing corporation's or controlled corporation's assets be used in that active trade or business in order for the active trade or business test to be satisfied. Because certain non-pro rata distributions resemble redemptions for cash, the Administration proposes to require that in the case of a non-pro rata distribution, in order for a corporation to satisfy the active trade or business test, as of the date of the distribution, at least 50 percent of its assets, by value, must be used or held for use in a trade or business that satisfies the active trade or business test.

Impose penalties on charities that fail to enforce conservation easements.—Although gifts of partial interests in property generally are not deductible as charitable contributions, current law allows a deduction for certain restrictions granted in perpetuity on the use that may be made of real property (such as an easement). A deduction is allowed only if the contribution is made to a qualified organization exclusively for conservation purposes. To qualify to receive such qualified conservation contributions, a charity must have a commitment to protect the conservation purposes of the donation and have the resources to enforce the restrictions. The Department of Treasury is concerned that in some cases charities are failing to monitor and enforce the conservation restrictions for which charitable contribution deductions were claimed. The proposal would impose significant penalties on any charity that removes or fails to enforce such a conservation restriction, or transfers the easement without ensuring that the conservation purposes will be protected in perpetuity. The amount of the penalty would be determined based on the value of the easement shown on the appraisal summary provided to the charity by the donor. The Secretary of the Treasury would be authorized to waive the penalty in certain circumstances. The Secretary of the Treasury also would be authorized to require such additional reporting as may be necessary or appropriate to ensure that the conservation purposes are protected in perpetuity.

Eliminate the special exclusion from unrelated business taxable income for gain or loss on the sale or exchange of certain brownfields.—In general, an organization that is otherwise exempt from Federal income tax is taxed on income from any trade or business regularly carried on by the organization that is not substantially related to the organization's exempt purposes. In addition, income derived from property that is debt-financed generally is subject to unrelated business income tax. The 2004 job creation act created a special exclusion from unrelated business taxable income of gain or loss from the sale or exchange of certain qualifying brownfield properties. The exclusion applies regardless of whether the property is debt-financed. The new provision adds considerable complexity to the Internal Revenue Code and, because there is no limit on the amount of tax-free gain, could exempt from tax real estate development considerably beyond mere environmental remediation. The proposal would eliminate this special exclusion effective for taxable years beginning after December 31, 2006.

Limit related party interest deductions.—Current law (section 163(j) of the Internal Revenue Code) denies U.S. tax deductions for certain interest expenses paid to a related party where: (1) the corporation's debt-to-equity ratio exceeds 1.5 to 1, and (2) net interest expenses exceed 50 percent of the corporation's adjusted taxable income (computed by adding back net interest expense, depreciation, amortization, depletion, and any net operating loss deduction). If these thresholds are exceeded, no deduction is allowed for interest in excess of the 50-percent limit that is paid to a related party or paid to an unrelated party but guaranteed by a related party, and that is not subject to U.S. tax. Any interest that is disallowed in a given year is carried forward indefinitely and may be deductible in a subsequent taxable year. A three-year carryforward for any excess limitation (the amount by which interest expense for a given year falls short of the 50-percent limit) is also allowed. Because of the opportunities available under current law to reduce inappropriately U.S. tax on income earned on U.S. operations through the use of foreign related-party debt, the Administration proposes to tighten the interest disallowance rules of section 163(j) as follows: (1) the current law 1.5 to 1 debt-to-equity safe harbor would be eliminated; (2) the adjusted taxable income threshold for the limitation would be reduced from 50 percent to 25 percent of adjusted taxable income with respect to disqualified interest other than interest paid to unrelated parties on debt that is subject to a related-party guarantee, which generally would remain subject to the current law 50 percent threshold; and (3) the indefinite carryforward for disallowed interest would be limited to ten years and the three-year carryforward of excess limitation would be eliminated. The Department of Treasury also is conducting a study of these rules and the potential for further modifications to ensure the prevention of inappropriate income-reduction opportunities.

Clarify and simplify qualified tuition programs.—Current law provides special tax treatment for contributions to and distributions from qualified tuition programs under Section 529. The purpose of these programs is to encourage saving for the higher education expenses of designated beneficiaries. However, current law is unclear in certain situations with regard to the transfer tax consequences of changing the designated beneficiary of a qualified tuition program account. In addition, current law creates opportunities for inappropriate use of these accounts. The proposal would simplify the tax consequences under these programs and promote use of these accounts to save for higher education. The most significant change made by this proposal is the elimination of substantially all post-contribution transfer taxes, thus permitting tax-free changes of the designated beneficiary of an account, without limitation as to the relationship or number of generations between the current and former beneficiaries. Any distribution used to pay the beneficiary's qualified higher education expenses would continue to be tax-free. However, to eliminate the potential transfer tax benefit of using an account for purposes not intended by the statute, any distribution that is not used for higher education expenses generally would be subject to a new excise tax (payable from the account) once the cumulative amount of these distributions exceeds a stated amount per beneficiary. Distributions from an account would be permitted to be made only to or for the benefit of the designated beneficiary. However, a contributor who sets up an account would be permitted to withdraw funds from the account during the contributor's life, subject to income tax on the income portion of the withdrawal. The income portion of a withdrawal by the account's contributor generally also would be subject to an additional tax to discourage individuals from using these accounts to save for retirement. The proposal would be effective for Section 529 accounts established after the date of enactment, and no additional contributions would be permitted to preexisting Section 529 savings accounts unless those accounts elect to be governed by the new rules.

TAX ADMINISTRATION, UNEMPLOYMENT INSURANCE, AND OTHER

Improve Tax Administration

Implement IRS administrative reforms.—The proposed modification to the IRS Restructuring and Reform Act of 1998 is comprised of five parts. The first part modifies employee infractions subject to mandatory termination and permits a broader range of available penalties. It strengthens taxpayer privacy while reducing employee anxiety resulting from unduly harsh discipline or unfounded allegations. The second part adopts measures to curb frivolous submissions and filings that are intended to impede or delay tax administration. The third part allows the IRS to terminate installment agreements when taxpayers fail to make timely tax deposits and file tax returns on current liabilities. The fourth part streamlines jurisdiction over collection due process cases in the Tax Court, thereby simplifying procedures and reducing the cycle time for certain collection due process cases. The fifth part eliminates the requirement that the IRS Chief Counsel provide an opinion for any accepted offer-in-compromise of unpaid tax (including interest and penalties) equal to or exceeding $50,000. This proposal requires that the Secretary of the Treasury establish standards to determine when an opinion is appropriate.

Initiate IRS cost saving measures.—The Administration has two proposals to improve IRS efficiency and performance from current resources. The first proposal modifies the way that Financial Management Services (FMS) recovers its transaction fees for processing IRS levies by permitting FMS to retain a portion of the amount collected before transmitting the balance to the IRS, thereby reducing Government transaction costs. The offset amount would be included as part of the 15-percent limit on continuous levies against income and would also be credited against the taxpayer's liability. The second proposal would provide the IRS additional authority to require electronic filing. This proposal would allow the IRS to process more returns and payments efficiently.

Allow IRS to access information in the National Directory of New Hires for tax administration purposes.—The National Directory of New Hires (NDNH), an electronic database maintained by the Department of Health and Human Services, contains timely, uniformly compiled employment data from State agencies across the country. Currently, the IRS may obtain data from the NDNH, but only for limited purposes. Access to NDNH data for tax administration purposes generally would make the IRS more productive by reducing the amount of resources it must dedicate to obtaining and processing data. The Administration proposes to amend the Social Security Act to allow the IRS access to NDNH data for general tax administration purposes, including data matching, verification of taxpayer claims during return processing, preparation of substitute returns for non-compliant taxpayers, and identification of levy sources. Data obtained by the IRS from the NDNH would be protected by existing taxpayer privacy law, including civil and criminal sanctions. The proposal would be effective on the date of enactment.

Extend IRS authority to fund undercover operations.—Current law places the IRS on equal footing with other Federal law enforcement agencies by permitting the IRS to fund certain necessary and reasonable expenses of undercover operations. These undercover operations include international and domestic money laundering and narcotics operations. The Administration proposes to extend this funding authority, which expires on December 31, 2006, through December 31, 2010.

Reduce the tax gap.—While the vast majority of American taxpayers pay their taxes timely and accurately, the nation still has a significant tax gap, which is the difference between what taxpayers should pay and what they actually pay on a timely basis. The IRS has taken a number of steps to bolster enforcement; however, it is unlikely that IRS will be able to narrow the tax gap to an acceptable level through enforcement alone. In an effort to reduce the tax gap with minimum taxpayer burden, the Administration proposes to: (1) Clarify the circumstances in which employee leasing companies and their clients can be held jointly liable for Federal employment taxes. (2) Require debit and credit card issuers to report to the IRS gross reimbursements paid to certain businesses. (3) Require increased information reporting for certain non-wage payments made by Federal, State and local governments to procure property and services. (4) Amend collections due process procedures applicable to Federal employment taxes. (5) Expand return preparer identification and penalty provisions. In addition, the Department of Treasury will study the standards used to distinguish between employees and independent contractors for purposes of withholding and paying Federal employment taxes.

Strengthen Financial Integrity of Unemployment Insurance

Strengthen the financial integrity of the unemployment insurance system by reducing improper benefit payments and tax avoidance.—The Administration has a multi-part proposal to strengthen the financial integrity of the unemployment insurance (UI) system and to encourage the early reemployment of UI beneficiaries. The Administration's proposal will boost States' ability to recover benefit overpayments and deter tax evasion schemes by permitting them to use a portion of recovered funds to expand enforcement efforts in these areas. In addition, the proposal would require States to impose a monetary penalty on UI benefit fraud, which would be used to reduce overpayments; make it easier for States to use private collection agencies in the recovery of hard-to-collect overpayments and delinquent employer taxes; require States to charge employers found to be at fault when their actions lead to overpayments; permit collection of delinquent UI overpayments and employer taxes through garnishment of Federal tax refunds; and improve the accuracy of hiring data in the National Directory of New Hires, which would reduce benefit overpayments. The Administration's proposal would also permit States to request waivers of certain Federal requirements in order to carry out demonstration projects that speed reemployment of individuals eligible for UI. These efforts to strengthen the financial integrity of the UI system and encourage early reemployment of UI beneficiaries will keep State UI taxes down and improve the solvency of the State trust funds.

Extend unemployment insurance surtax.—The unemployment insurance surtax of 0.2 percent imposed on employers is scheduled to expire with respect to wages paid after December 31, 2007. This tax is proposed to be extended for five years, through December 31, 2012.

Other Proposals

Increase Indian gaming activity fees.—The National Indian Gaming Commission regulates and monitors gaming operations conducted on Indian lands. Since 1998, the Commission has had a fixed ceiling on what it may collect in annual fees from gaming operations to cover the costs of its oversight responsibilities. The Administration proposes to amend the current fee structure so that the Commission can adjust its activities to the growth in the Indian gaming industry.

MODIFY ENERGY POLICY ACT OF 2005

Repeal reduced recovery period for natural gas distribution lines.—The Energy Policy Act of 2005 reduced the recovery period for certain natural gas distribution lines from 20 years to 15 years (see the discussion of the Energy Policy Act of 2005 in this Chapter). The Administration proposes to repeal this provision for natural gas distribution lines placed in service after December 31, 2006.

Modify amortization for certain geological and geophysical expenditures.—Under the Energy Policy Act of 2005, geological and geophysical expenditures paid or incurred in taxable years beginning after August 8, 2005, in connection with oil and gas exploration in the United States, may be amortized over two years. The Administration proposes to increase the amortization period to five years for amounts paid or incurred in taxable years beginning after December 31, 2006.

PROMOTE TRADE

Implement free trade agreements.—Free trade agreements continue to be negotiated with Thailand, Colombia, Ecuador, Panama, and the United Arab Emirates (UAE), with an expectation—once completed—that the 10-year implementation will begin as early as FY 2007. The recently completed agreements with Oman and Peru could also begin implementation in 2007. A free trade agreement is expected to be completed with the Southern African Customs Union (SACU), with 10-year implementation to begin in FY 2008. These agreements will continue the Administration's effort to use free trade agreements to benefit U.S. consumers and producers as well as strengthen the economies of our partner countries.

Extend Generalized System of Preferences (GSP).—Under GSP, duty-free access is provided to approximately 3,400 products from eligible beneficiary developing countries that meet certain worker rights, intellectual property protection, and other statutory criteria. The Administration proposes to extend this program, which is scheduled to expire after December 31, 2006, through December 31, 2011.

EXTEND EXPIRING PROVISIONS

Extend minimum tax relief for individuals.—A temporary provision of current law increased the alternative minimum tax (AMT) exemption amounts to $40,250 for single taxpayers, $58,000 for married taxpayers filing a joint return and surviving spouses, and $29,000 for married taxpayers filing a separate return and estates and trusts. Effective for taxable years beginning after December 31, 2005, the AMT exemption amounts decline to $33,750 for single taxpayers, $45,000 for married taxpayers filing a joint return and surviving spouses, and $22,500 for married taxpayers filing a separate return and estates and trusts. The Administration proposes to extend the temporary, higher exemption amounts through taxable year 2006.

A temporary provision of current law permits nonrefundable personal tax credits to offset both the regular tax and the alternative minimum tax for taxable years beginning before January 1, 2006. The Administration proposes to extend minimum tax relief for nonrefundable personal credits for one year, to apply to taxable year 2006. The proposed extension does not apply to the child credit, the new saver credit, the earned income credit or the adoption credit, which were provided AMT relief through December 31, 2010 under the 2001 tax cut. The refundable portion of the child credit and the earned income tax credit are also allowed against the AMT through December 31, 2010.

Extend permanently the research and experimentation (R&E) tax credit.—The Administration proposes to extend permanently the 20-percent tax credit for qualified research and experimentation expenditures above a base amount and the alternative incremental credit, which expired on December 31, 2005.

In addition, the Administration is concerned that features of the R&E tax credit may limit its effectiveness in encouraging taxpayers to invest in R&E. The Administration will work closely with the Congress to develop and enact reforms to modernize the R&E tax credit and improve its incentive effect.

***Extend and modify the work opportunity tax credit and the welfare-to-work tax credit*.**—Under present law, the work opportunity tax credit provides incentives for hiring individuals from certain targeted groups. The credit generally applies to the first $6,000 of wages paid to several categories of economically disadvantaged or handicapped workers. The credit rate is 25 percent of qualified wages for employment of at least 120 hours but less than 400 hours and 40 percent for employment of 400 or more hours. The credit is available for a qualified individual who begins work before January 1, 2006.

Under present law, the welfare-to-work tax credit provides an incentive for hiring certain recipients of long-term family assistance. The credit is 35 percent of up to $10,000 of eligible wages in the first year of employment and 50 percent of wages up to $10,000 in the second year of employment. Eligible wages include cash wages plus the cash value of certain employer-paid health, dependent care, and educational fringe benefits. The minimum employment period that employees must work before employers can claim the credit is 400 hours. This credit is available for qualified individuals who begin work before January 1, 2006.

The Administration proposes to simplify employment incentives by combining the credits into one credit and making the rules for computing the combined credit simpler. The credits would be combined by creating a new welfare-to-work targeted group under the work opportunity tax credit. The minimum employment periods and credit rates for the first year of employment under the present work opportunity tax credit would apply to welfare-to-work employees. The maximum amount of eligible wages would continue to be $10,000 for welfare-to-work employees and $6,000 for other targeted groups. In addition, the second year 50-percent credit currently available under the welfare-to-work credit would continue to be available for welfare-to-work employees under the modified work opportunity tax credit. Qualified wages would be limited to cash wages. The work opportunity tax credit would also be simplified by eliminating the need to determine family income for qualifying ex-felons (one of the present targeted groups). The modified work opportunity tax credit would apply to individuals who begin work after December 31, 2005 and before January 1, 2007.

***Extend the first-time homebuyer credit for the District of Columbia*.**—A one-time nonrefundable $5,000 credit is available to purchasers of a principal residence in the District of Columbia who have not owned a residence in the District during the year preceding the purchase. The credit phases out for taxpayers with modified adjusted gross income between $70,000 and $90,000 ($110,000 and $130,000 for joint returns). The credit does not apply to purchases after December 31, 2005. The Administration proposes to extend the credit for one year, making the credit available with respect to purchases after December 31, 2005 and before January 1, 2007.

***Extend authority to issue Qualified Zone Academy Bonds*.**—Current law allows State and local governments to issue "qualified zone academy bonds," the interest on which is effectively paid by the Federal government in the form of an annual income tax credit. The proceeds of the bonds have to be used for teacher training, purchases of equipment, curriculum development, or rehabilitation and repairs at certain public school facilities. A nationwide total of $400 million of qualified zone academy bonds were authorized to be issued in each of calendar years 1998 through 2005. In addition, unused authority arising in 1998 and 1999 can be carried forward for up to three years and unused authority arising in 2000 through 2005 can be carried forward for up to two years. The Administration proposes to authorize the issuance of an additional $400 million of qualified zone academy bonds in calendar year 2006; unused authority could be carried forward for up to two years. Reporting of issuance would be required.

***Extend provisions permitting disclosure of tax return information relating to terrorist activity*.**—Current law permits disclosure of tax return information relating to terrorism in two situations. The first is when an executive of a Federal law enforcement or intelligence agency has reason to believe that the return information is relevant to a terrorist incident, threat or activity and submits a written request. The second is when the IRS wishes to apprise a Federal law enforcement agency of a terrorist incident, threat or activity. The Administration proposes to extend this disclosure authority, which expires on December 31, 2006, through December 31, 2007.

***Extend excise tax on coal at current rates*.**—Excise taxes levied on coal mined and sold for use in the United States are deposited in the Black Lung Disability Trust Fund. Amounts deposited in the Fund are used to cover the cost of program administration and compensation, medical, and survivor benefits to eligible miners and their survivors, when mine employment terminated prior to 1970 or when no mine operator can be assigned liability. Current tax rates on coal sold by a producer are $1.10 per ton of coal from underground mines and $0.55 per ton of coal from surface mines; however, these rates may not exceed 4.4 percent of the price at which the coal is sold. Effective for coal sold after December 31, 2013, the tax rates on coal from underground mines and surface mines will decline to $0.50 per ton and $0.25 per ton, respectively, and will be capped at 2 percent of the price at which the coal is sold. The Administration proposes to repeal the reduction in these tax rates effective for sales after December 31, 2013, and keep current rates in effect until the Black Lung Disability Trust Fund debt is repaid.

Table 17–3. EFFECT OF PROPOSALS ON RECEIPTS

(in millions of dollars)

	2006	2007	2008	2009	2010	2011	2007–11	2007–16
Make Permanent Certain Tax Cuts Enacted in 2001 and 2003 (assumed in the baseline):								
Dividends tax rate structure	288	571	–1,329	–14,161	–537	–6,545	–22,001	–128,050
Capital gains tax rate structure	...	...	...	–14,183	–5,519	–6,606	–26,308	–74,931
Expensing for small business	...	...	–4,679	–6,498	–4,872	–3,853	–19,902	–32,620
Marginal individual income tax rate reductions	...	...	...	...	...	–66,918	–66,918	–605,961
Child tax credit [1]	...	...	...	...	...	–5,452	–5,452	–116,691
Marriage penalty relief [2]	...	...	...	...	...	–4,968	–4,968	–37,578
Education incentives	...	...	...	...	3	–1,098	–1,095	–10,960
Repeal of estate and generation-skipping transfer taxes, and modification of gift taxes	–205	–1,102	–1,728	–2,181	–2,676	–23,758	–31,445	–339,022
Modifications of pension plans	...	...	...	...	...	–346	–346	–2,858
Other incentives for families and children	...	...	...	...	5	–170	–165	–4,362
Total make permanent certain tax cuts enacted in 2001 and 2003	83	–531	–7,736	–37,023	–13,596	–119,714	–178,600	–1,353,033
Tax Incentives:								
Simplify and encourage saving:								
Expand tax-free savings opportunities	...	4,796	10,407	7,507	3,970	–383	26,297	–122
Consolidate employer-based savings accounts	...	...	–542	–579	–618	–1,826	–3,565	–20,063
Establish Individual Development Accounts (IDAs)	...	...	–134	–286	–326	–300	–1,046	–1,763
Total simplify and encourage saving	...	4,796	9,731	6,642	3,026	–2,509	21,686	–21,948
Encourage entrepreneurship and investment:								
Increase expensing for small business	...	–2,522	–3,527	–2,625	–2,037	–1,645	–12,356	–18,713
Invest in health care:								
Expand health savings accounts (HSAs) [3]	...	–1,978	–4,321	–6,201	–7,720	–8,826	–29,046	–87,212
Provide an above-the-line deduction for high-deductible insurance premiums [4]	...	–2,519	–3,815	–3,840	–3,691	–3,668	–17,533	–38,127
Provide refundable tax credit for the purchase of health insurance [5]	...	–254	–861	–1,194	–1,404	–1,362	–5,075	–11,154
Improve the Health Coverage Tax Credit [6]	...	–1	–3	–4	–5	–5	–18	–51
Allow the orphan drug tax credit for certain pre-designation expenses [7]	...	...	...	...	...	...	...	...
Total invest in health care	...	–4,752	–9,000	–11,239	–12,820	–13,861	–51,672	–136,544
Provide incentives for charitable giving:								
Permit tax-free withdrawals from IRAs for charitable contributions	...	–102	–510	–512	–501	–497	–2,122	–4,706
Expand and increase the enhanced charitable deduction for contributions of food inventory	...	–44	–96	–106	–116	–127	–489	–1,345
Reform excise tax based on investment income of private foundations	...	–56	–85	–90	–96	–102	–429	–1,074
Modify tax on unrelated business taxable income of charitable remainder trusts	...	–1	–6	–6	–6	–6	–25	–62
Modify basis adjustment to stock of S corporations contributing appreciated property	...	–3	–15	–21	–25	–28	–92	–301
Repeal the $150 million limitation on qualified 501(c)(3) bonds	...	–2	–3	–6	–10	–11	–32	–81
Repeal certain restrictions on the use of qualified 501(c)(3) bonds for residential rental property	...	–2	–5	–9	–16	–24	–56	–278
Total provide incentives for charitable giving	...	–210	–720	–750	–770	–795	–3,245	–7,847
Strengthen education:								
Extend the above-the-line deduction for qualified out-of-pocket classroom expenses	–17	–171	–178	–180	–183	–185	–897	–1,867
Provide assistance to distressed areas:								
Establish Opportunity Zones	...	–221	–411	–439	–451	–482	–2,004	–4,960
Protect the environment:								
Extend permanently expensing of brownfields remediation costs	–98	–146	–163	–177	–168	–157	–811	–1,503
Restructure assistance to New York City:								
Provide tax incentives for transportation infrastructure	...	–200	–200	–200	–200	–200	–1,000	–2,000
Repeal certain New York City Liberty Zone incentives	...	200	200	200	200	200	1,000	2,000
Total restructure assistance to New York City	...	...	...	...	...	...	...	...
Total tax incentives	–115	–3,226	–4,268	–8,768	–13,403	–19,634	–49,299	–193,382

Table 17–3. EFFECT OF PROPOSALS ON RECEIPTS—Continued

(in millions of dollars)

	2006	2007	2008	2009	2010	2011	2007–11	2007–16
Simplify the Tax Laws for Families:								
Clarify uniform definition of a child [8]	....	17	66	50	32	48	213	395
Simplify EITC eligibility requirement regarding filing status, presence of children, and work and immigration status [9]	....	27	–24	–21	–26	–28	–72	–207
Reduce computational complexity of refundable child tax credit [10]	....	....	....	....	....	....	....	....
Total simplify the tax laws for families	....	44	42	29	6	20	141	188
Strengthen the Employer-Based Pension System:								
Ensure fair treatment of older workers in cash balance conversions and protect defined benefit plans	3	53	62	77	89	100	381	1,039
Strengthen funding for single-employer pension plans	....	536	2,290	–153	–2,336	–1,611	–1,274	–9,180
Reflect market interest rates in lump sum payments	....	....	–3	–9	–17	–24	–53	–274
Total strengthen the employer-based pension system	3	589	2,349	–85	–2,264	–1,535	–946	–8,415
Close Loopholes and Improve Tax Compliance:								
Combat abusive foreign tax credit transactions	....	1	2	2	3	3	11	26
Modify the active trade or business test	....	6	8	8	8	8	38	89
Impose penalties on charities that fail to enforce conservation easements	....	3	8	8	9	9	37	91
Eliminate the special exclusion from unrelated business taxable income for gain or loss on the sale or exchange of certain brownfields	....	2	14	30	43	41	130	201
Limit related party interest deductions	....	82	141	148	155	163	689	1,635
Clarify and simplify qualified tuition programs	....	4	12	13	14	20	63	222
Total close loopholes and improve tax compliance	....	98	185	209	232	244	968	2,264
Tax Administration, Unemployment Insurance, and Other:								
Improve tax administration:								
Implement IRS administrative reforms and initiate cost saving measures [11]	....	....	....	....	....	....	....	....
Reduce the tax gap	....	259	351	311	296	308	1,525	3,560
Total improve tax administration	....	259	351	311	296	308	1,525	3,560
Strengthen financial integrity of unemployment insurance:								
Strengthen the financial integrity of the unemployment insurance system by reducing improper benefit payments and tax avoidance [12]	....	....	31	30	–106	–143	–188	–2,246
Extend unemployment insurance surtax [12]	....	....	1,085	1,490	1,526	1,564	5,665	710
Total strengthen integrity of unemployment insurance [12]	....	....	1,116	1,520	1,420	1,421	5,477	–1,536
Other proposals:								
Increase Indian gaming activity fees	....	....	5	5	5	5	20	45
Total tax administration, unemployment insurance, and other [12]	....	259	1,472	1,836	1,721	1,734	7,022	2,069
Modify Energy Policy Act of 2005:								
Repeal reduced recovery period for natural gas distribution lines	....	12	44	80	112	125	373	833
Modify amortization for certain geological and geophysical expenditures	....	38	140	206	169	88	641	730
Total modify Energy Policy Act of 2005	....	50	184	286	281	213	1,014	1,563
Promote Trade:								
Implement free trade agreements [12]	....	–236	–456	–593	–741	–832	–2,858	–8,200
Extend GSP [12]	....	–412	–617	–666	–723	–786	–3,204	–3,445
Total promote trade [12]	....	–648	–1,073	–1,259	–1,464	–1,618	–6,062	–11,645
Extend Expiring Provisions:								
Minimum tax relief for individuals	–13,664	–20,495	....	....	....	....	–20,495	–20,495
Research & Experimentation (R&E) tax credit	–2,097	–4,601	–5,944	–6,889	–7,669	–8,340	–33,443	–86,440
Combined work opportunity/welfare-to-work tax credit	–80	–144	–86	–25	–7	–3	–265	–266
First-time homebuyer credit for DC	–1	–18	....	....	....	....	–18	–18
Authority to issue Qualified Zone Academy Bonds	–3	–8	–13	–18	–20	–20	–79	–179
Disclosure of tax return information related to terrorist activity [7]	....	....	....	....	....	....	....	....
Excise tax on coal [12]	....	....	....	....	....	....	....	750
Total extend expiring provisions [12]	–15,845	–25,266	–6,043	–6,932	–7,696	–8,363	–54,300	–106,648

Table 17–3. EFFECT OF PROPOSALS ON RECEIPTS—Continued

(in millions of dollars)

	2006	2007	2008	2009	2010	2011	2007–11	2007–16
Total budget proposals, including proposals assumed in the baseline [12]	–15,874	–28,631	–14,888	–51,707	–36,183	–148,653	–280,062	–1,667,039
Total budget proposals, excluding proposals assumed in the baseline [12]	–15,957	–28,100	–7,152	–14,684	–22,587	–28,939	–101,462	–314,006

[1] Affects both receipts and outlays. Only the receipt effect is shown here. The outlay effect is $45 million for 2011 and $51,809 million for 2007–2016.

[2] Affects both receipts and outlays. Only the receipt effect is shown here. The outlay effect is –$371 million for 2011 and $7,346 million for 2007–2016.

[3] Affects both receipts and outlays. Only the receipt effect is shown here. The outlay effect is $91 million for 2007, $178 million for 2008, $253 million for 2009, $310 million for 2010, $352 million for 2011, $1,184 million for 2007–2011 and $3,500 million for 2007–2016.

[4] Affects both receipts and outlays. Only the receipt effect is shown here. The outlay effect is $244 million for 2007, $315 million for 2008, $319 million for 2009, $303 million for 2010, $305 million for 2011, $1,486 million for 2007–2011 and $3,200 million for 2007–2016.

[5] Affects both receipts and outlays. Only the receipt effect is shown here. The outlay effect is $381 million for 2007, $747 million for 2008, $1,095 million for 2009, $1,249 million for 2010, $1,343 million for 2011, $4,815 million for 2007–2011 and $12,939 million for 2007–2016.

[6] Affects both receipts and outlays. Only the receipt effect is shown here. The outlay effect is $4 million for 2007, $10 million for 2008, $12 million for 2009, $14 million for 2010, $15 million for 2011, $55 million for 2007–2011 and $139 million for 2007–2016.

[7] No net budgetary impact.

[8] Affects both receipts and outlays. Only the receipt effect is shown here. The outlay effect is –$170 million for 2008, –$196 million for 2009, –$250 million for 2010, –$234 million for 2011, –$850 million for 2007–2011 and –$2,224 million for 2007–2016.

[9] Affects both receipts and outlays. Only the receipt effect is shown here. The outlay effect is –$188 million for 2007, $123 million for 2008, $102 million for 2009, $96 million for 2010, $95 million for 2011, $228 million for 2007–2011 and $687 million for 2007–2016.

[10] Affects both receipts and outlays. Only the receipt effect is shown here. The outlay effect is –$332 million for 2008, –$342 million for 2009, –$347 million for 2010, –$357 million for 2011, –$1,378 million for 2007–2011 and –$3,263 million for 2007–2016.

[11] Outlays from this proposal will be reflected in the Financial Management Service's budget.

[12] Net of income offsets.

Table 17–4. RECEIPTS BY SOURCE

(In millions of dollars)

Source	2005 Actual	Estimate					
		2006	2007	2008	2009	2010	2011
Individual income taxes (federal funds):							
Existing law	927,222	1,011,324	1,118,314	1,215,823	1,309,725	1,393,917	1,587,316
Proposed Legislation		–13,725	–21,948	–7,339	–41,279	–23,785	–120,447
Total individual income taxes	**927,222**	**997,599**	**1,096,366**	**1,208,484**	**1,268,446**	**1,370,132**	**1,466,869**
Corporation income taxes:							
Federal funds:							
Existing law	278,278	279,273	265,124	274,333	286,170	292,789	302,649
Proposed Legislation		–2,151	–4,557	–5,835	–9,034	–10,829	–10,637
Total Federal funds corporation income taxes	278,278	277,122	260,567	268,498	277,136	281,960	292,012
Trust funds:							
Hazardous substance superfund	4						
Total corporation income taxes	**278,282**	**277,122**	**260,567**	**268,498**	**277,136**	**281,960**	**292,012**
Social insurance and retirement receipts (trust funds):							
Employment and general retirement:							
Old-age and survivors insurance (Off-budget)	493,646	521,440	549,083	580,545	612,254	648,363	685,218
Disability insurance (Off-budget)	83,830	88,525	93,236	98,584	103,968	110,099	116,357
Hospital insurance	166,068	177,592	187,940	198,380	209,455	221,926	234,675
Railroad retirement:							
Social Security equivalent account	1,836	1,866	1,937	1,986	2,032	2,066	2,105
Rail pension and supplemental annuity	2,284	2,360	2,322	2,365	2,421	2,471	2,520
Total employment and general retirement	747,664	791,783	834,518	881,860	930,130	984,925	1,040,875
On-budget	170,188	181,818	192,199	202,731	213,908	226,463	239,300
Off-budget	577,476	609,965	642,319	679,129	716,222	758,462	801,575
Unemployment insurance:							
Deposits by States [1]	35,076	37,477	38,100	38,644	38,814	40,574	43,294
Proposed Legislation				39	38	–132	–178
Federal unemployment receipts [1]	6,829	7,269	7,084	5,911	5,585	5,946	6,689
Proposed Legislation				1,356	1,862	1,907	1,955
Railroad unemployment receipts [1]	97	86	90	104	119	122	122
Total unemployment insurance	42,002	44,832	45,274	46,054	46,418	48,417	51,882
Other retirement:							
Federal employees' retirement—employee share	4,409	4,423	4,285	4,186	4,083	3,989	3,895
Non-Federal employees retirement [2]	50	49	49	49	48	48	46
Total other retirement	4,459	4,472	4,334	4,235	4,131	4,037	3,941
Total social insurance and retirement receipts	**794,125**	**841,087**	**884,126**	**932,149**	**980,679**	**1,037,379**	**1,096,698**
On-budget	216,649	231,122	241,807	253,020	264,457	278,917	295,123
Off-budget	577,476	609,965	642,319	679,129	716,222	758,462	801,575
Excise taxes:							
Federal funds:							
Alcohol taxes	8,111	8,179	8,299	8,454	8,617	8,768	8,967
Proposed Legislation		–69	–95	–24			
Tobacco taxes	7,920	7,710	7,570	7,437	7,312	7,197	7,081
Transportation fuels tax	–770	–1,948	–2,451	–2,814	–2,921	–3,226	–780
Telephone and teletype services	6,047	6,069	6,106	6,143	6,182	6,222	6,261
Other Federal fund excise taxes	1,239	1,080	1,300	1,373	1,423	1,477	1,534
Proposed Legislation		69	58	–3	–29	–42	–60
Total Federal fund excise taxes	22,547	21,090	20,787	20,566	20,584	20,396	23,003
Trust funds:							
Highway	37,892	39,066	39,727	40,576	41,415	42,190	42,974
Airport and airway	10,314	10,651	11,341	11,995	12,694	13,436	14,222

Table 17–4. RECEIPTS BY SOURCE—Continued

(In millions of dollars)

Source	2005 Actual	Estimate 2006	2007	2008	2009	2010	2011
Sport fish restoration and boating	429	524	539	554	571	587	603
Tobacco	899	1,033	955	955	955	955	955
Black lung disability insurance	610	602	617	634	646	653	660
Inland waterway	91	81	77	76	77	78	80
Oil spill liability	....	88	183	192	203	212	223
Vaccine injury compensation	123	182	186	188	190	192	194
Leaking underground storage tank	189	194	196	201	206	207	210
Total trust funds excise taxes	50,547	52,421	53,821	55,371	56,957	58,510	60,121
Total excise taxes	**73,094**	**73,511**	**74,608**	**75,937**	**77,541**	**78,906**	**83,124**
Estate and gift taxes:							
Federal funds	24,764	27,521	24,925	26,041	27,603	21,504	18,688
Proposed Legislation	....	2	–1,225	–1,655	–1,591	–1,356	–17,133
Total estate and gift taxes	**24,764**	**27,523**	**23,700**	**24,386**	**26,012**	**20,148**	**1,555**
Customs duties:							
Federal funds	22,260	24,693	27,643	31,437	31,863	34,246	36,559
Proposed Legislation	....	....	–864	–1,432	–1,679	–1,951	–2,158
Trust funds	1,119	1,194	1,290	1,392	1,515	1,655	1,809
Total customs duties	**23,379**	**25,887**	**28,069**	**31,397**	**31,699**	**33,950**	**36,210**
MISCELLANEOUS RECEIPTS: [3]							
Miscellaneous taxes	342	342	443	438	438	438	438
Proposed Legislation	....	....	....	5	5	5	5
Exercise of warrants	1	....	....	....	....	....	....
United Mine Workers of America combined benefit fund	125	119	128	125	122	119	117
Deposit of earnings, Federal Reserve System	19,297	27,455	32,679	35,431	38,454	41,282	43,686
Defense cooperation	46	8	8	8	8	8	8
Fees for permits and regulatory and judicial services	9,825	10,110	10,442	10,609	10,860	11,018	11,304
Fines, penalties, and forfeitures	3,149	4,583	4,572	2,643	2,657	2,670	2,682
Gifts and contributions	234	201	200	204	206	208	209
Refunds and recoveries	–26	–56	–56	–56	–56	–56	–56
Total miscellaneous receipts	**32,993**	**42,762**	**48,416**	**49,407**	**52,694**	**55,692**	**58,393**
Total budget receipts	**2,153,859**	**2,285,491**	**2,415,852**	**2,590,258**	**2,714,207**	**2,878,167**	**3,034,861**
On-budget	1,576,383	1,675,526	1,773,533	1,911,129	1,997,985	2,119,705	2,233,286
Off-budget	577,476	609,965	642,319	679,129	716,222	758,462	801,575
MEMORANDUM							
Federal funds	1,310,401	1,391,759	1,481,180	1,603,674	1,677,442	1,783,065	1,878,730
Trust funds	546,513	620,753	672,520	699,346	727,925	761,693	805,257
Interfund transactions	–280,531	–336,986	–380,167	–391,891	–407,382	–425,053	–450,701
Total on-budget	**1,576,383**	**1,675,526**	**1,773,533**	**1,911,129**	**1,997,985**	**2,119,705**	**2,233,286**
Off-budget (trust funds)	**577,476**	**609,965**	**642,319**	**679,129**	**716,222**	**758,462**	**801,575**
Total	**2,153,859**	**2,285,491**	**2,415,852**	**2,590,258**	**2,714,207**	**2,878,167**	**3,034,861**

[1] Deposits by States cover the benefit part of the program. Federal unemployment receipts cover administrative costs at both the Federal and State levels. Railroad unemployment receipts cover both the benefits and adminstrative costs of the program for the railroads.
[2] Represents employer and employee contributions to the civil service retirement and disability fund for covered employees of Government-sponsored, privately owned enterprises and the District of Columbia municipal government.
[3] Includes both Federal and trust funds.

18. USER CHARGES AND OTHER COLLECTIONS

In addition to collecting taxes and other receipts by the exercise of its sovereign powers, which is discussed in the previous chapter, the Federal Government collects income from the public from market-oriented activities and the financing of regulatory expenses. These collections are classified as user charges, and they include the sale of postage stamps and electricity, charges for admittance to national parks, premiums for deposit insurance, and proceeds from the sale of assets, such as rents and royalties for the right to extract oil from the Outer Continental Shelf.

Depending on the laws that authorize the collections, they are credited to expenditure accounts as "offsetting collections," or to receipt accounts as "offsetting receipts." The budget refers to these amounts as "offsetting" because they are subtracted from gross outlays rather than added to taxes on the receipts side of the budget. The purpose of this treatment is to produce budget totals for receipts, outlays, and budget authority in terms of the amount of resources allocated governmentally, through collective political choice, rather than through the market.[1]

Usually offsetting collections are authorized to be spent for the purposes of the account without further action by the Congress. Offsetting receipts may or may not be earmarked for a specific purpose, depending on the legislation that authorizes them. When earmarked, the authorizing legislation may either authorize them to be spent without further action by the Congress, or require them to be appropriated in annual appropriations acts before they can be spent.

Offsetting collections and receipts include most user charges, which are discussed below, as well as some amounts that are not user charges. Table 18–1 summarizes these transactions. For 2007, total offsetting collections and receipts from the public are estimated to be $312.9 billion, and total user charges are estimated to be $243.2 billion.

The following section discusses user charges and the Administration's user charge proposals. The subsequent section displays more information on offsetting collections and receipts. The offsetting collections and receipts by agency are displayed in Table 21–1, which appears in Chapter 21, "Outlays to the Public, Gross and Net," of this volume.

Table 18–1. GROSS OUTLAYS, USER CHARGES, OTHER OFFSETTING COLLECTIONS AND RECEIPTS FROM THE PUBLIC, AND NET OUTLAYS

(in billions)

	Actual 2005	Estimate 2006	Estimate 2007
Gross outlays	2,728.8	2,993.1	3,083.0
Offsetting collections and receipts from the public:			
User charges [1]	181.8	205.6	239.8
Other	74.8	78.8	73.0
Subtotal, offsetting collections and receipts from the public	256.6	284.4	312.9
Net outlays	2,472.2	2,708.7	2,770.1

[1]Total user charges are shown below. They include user charges that are classified on the receipts side of the budget in addition to the amounts shown on this line. For additional details of total user charges, see Table 18–2, "Total User Charge Collections."

Total user charges:			
Offsetting collections and receipts from the public	181.8	205.6	239.8
Receipts	3.4	3.5	3.4
Total, User charges	185.2	209.1	243.2

[1] Showing collections from business-type transactions as offsets on the spending side of the budget follows the concept recommended by the *Report of the President's Commission on Budget Concepts* in 1967. The concept is discussed in Chapter 26: "The Budget System and Concepts" in this volume.

USER CHARGES

I. Introduction and Background

The Federal Government may charge those who benefit directly from a particular activity or those subject to regulation. Based on the definition used in this chapter, Table 18–2 shows that user charges were $185.2 billion in 2005, and are estimated to increase to $209.1 billion in 2006 and to $243.2 billion in 2007, growing to an estimated $258.5 billion in 2011, including the user charges proposals that are shown in Table 18–3. This table shows that the Administration's user charge proposals, including extension of expiring charges, would increase user charges by an estimated $3.5 billion in 2007, growing to an estimated $9.7 billion in 2011.

Definition. User charges are fees, charges, and assessments levied on individuals or organizations directly benefiting from, or subject to regulation by, a Government program or activity. In addition, the payers of the charge must be limited to those benefiting from, or subject to regulation by, the program or activity, and may not include the general public or a broad segment of the public (such as those who pay income taxes or customs duties).

- Examples of business-type or market-oriented user charges include charges for the sale of postal services (the sale of stamps), electricity (e.g., sales by the Tennessee Valley Authority), proceeds from the sale of goods by defense commissaries, payments for Medicare voluntary supplemental medical insurance, life insurance premiums for veterans, recreation fees for parks, and proceeds from the sale of assets (property, plant, and equipment) and natural resources (such as timber, oil, and minerals).
- Examples of regulatory and licensing user charges include charges for regulating the nuclear energy industry, bankruptcy filing fees, immigration fees, food inspection fees, passport fees, and patent and trademark fees.

The "user charges" concept used here aligns these estimates with the concept that establishes policy for charging prices to the public for the sale or use of goods, services, property, and resources (see OMB Circular No. A–25, "User Charges," July 8, 1993).

User charges do not include all offsetting collections and receipts from the public, such as repayments received from credit programs; interest, dividends, and other earnings; payments from one part of the Federal Government to another; or cost sharing contributions. Nor do they include earmarked taxes (such as taxes paid to social insurance programs or excise taxes on gasoline), or customs duties, fines, penalties, and forfeitures.

Alternative definitions. The definition used in this chapter is useful because it is similar to the definition used in OMB Circular No. A–25, "User Charges," which provides policy guidance to Executive Branch agencies on setting prices for user charges. Alternative definitions may be used for other purposes. Much of the discussion of user charges below—their purpose, when they should be levied, and how the amount should be set—applies to these alternatives as well.

Other definitions of user charges could, for example:

- be narrower than the one used here, by limiting the definition to proceeds from the sale of goods and services (and excluding the sale of assets), and by limiting the definition to include only proceeds that are earmarked to be used specifically to finance the goods and services being provided. This definition is similar to one the House of Representatives uses as a guide for purposes of committee jurisdiction. (See the *Congressional Record*, January 3, 1991, p. H31, item 8.)
- be even narrower than the user fee concept described above, by excluding regulatory fees and focusing solely on business-type transactions.
- be broader than the one used in this chapter by including beneficiary- or liability-based excise taxes, such as gasoline taxes. [2]

What is the purpose of user charges? The purpose of user charges is to improve the efficiency and equity of certain Government activities, and to reduce the burden on taxpayers to finance activities whose benefits accrue to a relatively limited number of people, or to impose a charge on activities that impose a cost on the public.

User charges that are set to cover the costs of production of goods and services can provide efficiency in the allocation of resources within the economy. They allocate goods and services to those who value them the most, and they signal to the Government how much of the goods or services it should provide. Prices in private, competitive markets serve the same purposes.

User charges for goods and services that do not have special social benefits improve equity, or fairness, by requiring that those who benefit from an activity are the same people who pay for it. The public often perceives user charges as fair because those who benefit from the good or service pay for it in whole or in part, and those who do not benefit do not pay.

When should the Government charge a fee? Discussions of whether to finance spending with a tax or a fee often focus on whether the benefits of the activity are to the public in general or to a limited group of people. In general, if the benefits accrue broadly to the public, then the program should be financed by taxes paid by the public; in contrast, if the benefits accrue to a limited number of private individuals or organizations, then the program should be financed by charges paid by the private beneficiaries. For Federal

[2] Beneficiary- and liability-based taxes are terms taken from the Congressional Budget Office, *The Growth of Federal User Charges*, August 1993, and updated in October 1995. In addition to gasoline taxes, examples of beneficiary-based taxes include taxes on airline tickets, which finance air traffic control activities and airports. An example of a liability-based tax is the excise tax that formerly helped fund the hazardous substance superfund in the Environmental Protection Agency. This tax was paid by industry groups to finance environmental cleanup activities related to the industry activity but not necessarily caused by the payer of the fee.

programs where the benefits are entirely public or entirely private, applying this principle is relatively easy. For example, according to this principle, the benefits from national defense accrue to the public in general and should be (and are) financed by taxes. In contrast, the benefits of electricity sold by the Tennessee Valley Authority accrue exclusively to those using the electricity, and should be (and are) financed by user charges.

In many cases, however, an activity has benefits that accrue to both public and to private groups, and it may be difficult to identify how much of the benefits accrue to each. Because of this, it can be difficult to know how much of the program should be financed by taxes and how much by fees. For example, the benefits from recreation areas are mixed. Fees for visitors to these areas are appropriate because the visitors benefit directly from their visit, but the public in general also benefits because these areas protect the Nation's natural and historic heritage now and for posterity.

As a further complication, where a fee may be appropriate to finance all or part of an activity, some consideration must be given to the ease of administering the fee.

What should be the amount of the fee? For programs that have private beneficiaries, the amount of the charge should depend on the costs of producing the goods or services and the portion of the program that is for private benefits. If the benefit is primarily private, and any public benefits are incidental, current policies support charges that cover the full cost to the Government, including both direct and indirect costs.[3]

The Executive Branch is working to put cost accounting systems in place across the Government that would make the calculation of full cost more feasible. The difficulties in measuring full cost are associated in part with allocating to an activity the full costs of capital, retirement benefits, and insurance, as well as other Federal costs that may appear in other parts of the budget. Guidance in the Statement of Federal Financial Accounting Standards No. 4, "Managerial Cost Accounting Standards" for the Federal Government (July 31, 1995), should underlie cost accounting in the Federal Government.

Classification of user charges in the budget. As shown in Table 18–1, most user charges are classified as offsets to outlays on the spending side of the budget, but a few are classified on the receipts side of the budget. An estimated $3.4 billion in 2007 are classified on the receipts side and are included in the totals described in Chapter 17. "Federal Receipts." They are classified as receipts because they are regulatory charges collected by the Federal Government by the exercise of its sovereign powers. Examples include filing fees in the United States courts, agricultural quarantine inspection fees, and passport fees.

The remaining user charges, an estimated $239.8 billion in 2007, are classified as offsetting collections and receipts on the spending side of the budget. Some of these are collected by the Federal Government by the exercise of its sovereign powers and conceptually would appear on the receipts side of the budget, but are required by law to be classified on the spending side as offsetting collections or receipts.

An estimated $136.5 billion of user charges for 2007 are credited directly to expenditure accounts, and are generally available for expenditure when they are collected, without further action by the Congress. An estimated $103.3 billion of user charges for 2007 are deposited in offsetting receipt accounts, and are available to be spent only according to the legislation that established the charges.

As a further classification, the accompanying Tables 18–2 and 18–3 identify the user charges as discretionary or mandatory. These classifications are terms from the Budget Enforcement Act of 1990 as amended and are used frequently in the analysis of the budget. "Discretionary" in this chapter refers to user charges generally controlled through annual appropriations acts and under the jurisdiction of the appropriations committees in the Congress. "Mandatory" refers to user charges controlled by permanent laws and under the jurisdiction of the authorizing committees.

These and other classifications are discussed further in this volume in Chapter 26, "The Budget System and Concepts."

II. TOTAL USER CHARGES

As shown in Table 18–2, total user charge collections (including those proposed in this Budget) are estimated to be $243.2 billion in 2007, increasing to $258.5 billion in 2011. User charge collections by the Postal Service and for Medicare premiums are the largest and are estimated to be more than half of total user charge collections in 2007.

[3] Policies for setting user charges are promulgated in OMB Circular No. A–25: "User Charges" (July 8, 1993).

Table 18–2. TOTAL USER CHARGE COLLECTIONS

(in millions of dollars)

	Actual 2005	Estimates 2006	2007	2008	2009	2010	2011
Receipts							
Judicial Branch: Filing fees, U. S. courts	275	308	306	333	332	340	343
Department of Agriculture: Agricultural quarantine inspection fees	338	363	368	371	376	380	388
Department of the Interior: Abandoned mine reclamation fund	293	300	....	....	....	....	....
Department of State: Immigration, passport, and consular fees	911	835	922	924	923	922	921
Corps of Engineers: Harbor maintenance fees	1,048	1,133	1,228	1,329	1,451	1,590	1,743
Other charges	546	536	547	341	345	348	351
Subtotal, receipts	3,411	3,475	3,371	3,298	3,427	3,580	3,746
Offsetting Collections and Receipts from the Public							
Discretionary							
Department of Agriculture: Food safety inspection and other charges	299	324	364	352	351	346	350
Department of Commerce: Patent and trademark, fees for weather services, and other charges	1,596	1,810	1,970	1,892	2,059	2,245	2,434
Department of Defense: Commissary and other charges	8,934	9,135	9,901	9,903	9,903	9,903	9,903
Department of Energy: Federal Energy Regulation Commission, power marketing, and other charges	785	1,077	1,256	1,213	1,206	1,190	1,205
Department of Health and Human Services: Food and Drug Administration, Centers for Medicare and Medicaid Services, and other charges	1,377	977	1,175	1,039	1,033	1,018	1,031
Department of Homeland Security: Border and Transportation Security and other charges	2,044	2,384	4,115	4,319	4,535	4,759	4,996
Department of the Interior: Minerals Management Service and other charges	533	550	842	630	544	527	552
Department of Justice: charges for bankruptcy oversight and other charges	309	339	486	470	467	461	466
Department of State: Passport and other charges	1,605	1,129	1,390	1,437	1,496	1,554	1,623
Department of Transportation: Pipeline safety and other charges	115	111	114	110	110	109	110
Department of the Treasury: Sale of commemorative coins and other charges	1,550	2,428	2,521	2,436	2,423	2,390	2,418
Department of Veterans Affairs: Medical care and other charges	1,938	2,131	2,916	3,062	3,208	3,350	3,592
General Services Administration: Acquisition services fund and other charges	49	603	594	582	580	573	580
Social Security Administration, State supplemental fees, supplemental security income	123	119	119	115	114	113	114
Federal Communications Commission: Regulatory fees	378	374	387	374	373	369	373
Federal Trade Commission: Regulatory fees	118	139	138	151	156	159	163
National Credit Union Administration: Collections	152	172	197	215	220	224	229
Nuclear Regulatory Commission: Regulatory fees	534	624	627	609	608	602	611
Securities and Exchange Commission: Regulatory fees	1,665	2,144	1,116	1,140	1,321	1,504	1,724
All other agencies, discretionary user charges	–2,845	320	369	364	357	349	353
Subtotal, discretionary user charges	21,259	26,890	30,597	30,413	31,064	31,745	32,827
Mandatory							
Department of Agriculture: Crop insurance and other charges	1,880	1,559	1,847	1,841	1,802	1,863	1,908
Department of Defense: Commissary surcharge and other charges	1,090	657	545	598	645	661	687
Department of Energy: Proceeds from the sale of energy, nuclear waste disposal and other charges	4,709	4,406	4,781	4,709	4,882	4,822	4,888
Department of Health and Human Services: Medicare Part B insurance premiums and other charges	39,854	48,186	55,546	59,765	62,853	65,415	69,071
Department of Homeland Security: Customs, immigration, and other charges	6,196	6,790	7,140	7,480	7,841	8,203	8,557
Department of the Interior: Recreation and other charges	5,584	6,629	6,329	6,265	5,970	5,786	5,837
Department of Justice: Federal Prison Commissary fees and other charges	400	472	487	500	514	528	543
Department of Labor: Insurance premiums to guarantee private pensions and other collections	2,519	4,039	5,416	10,032	10,577	11,034	11,522
Department of the Treasury: Bank regulation, and other charges	875	919	1,107	1,136	1,161	1,189	1,216
Department of Veterans Affairs: Veterans life insurance and other charges	1,682	2,576	1,864	1,826	1,801	1,768	1,746
Office of Personnel Management: Federal employee health and life insurance fees	10,298	11,053	11,921	12,826	13,718	14,726	15,869
Federal Deposit Insurance Corporation: Deposit insurance fees	707	1,378	1,430	2,745	5,239	7,299	8,364
National Credit Union Administration: Credit union share insurance and other charges	324	293	323	285	220	219	224
Postal Service: Fees for postal services	68,504	71,176	71,491	71,678	71,872	72,066	72,310
Tennessee Valley Authority: Proceeds from the sale of energy	7,806	8,621	8,937	8,443	8,428	8,708	8,987
Undistributed Offsetting Receipts:							
Executive Office of the President: Spectrum relocation receipts	....	....	9,720	1,080	....	....	....
Federal Communications Commission: Auction receipts	160	110	9,950	1,150	100	100	100
Outer Continental Shelf receipts and other collections	6,146	9,118	9,591	16,761	9,460	10,134	9,209
All other agencies, mandatory user charges	1,818	728	820	831	851	864	888
Subtotal, mandatory user charges	160,552	178,710	209,245	209,951	207,934	215,385	221,926
Subtotal, user charges that are offsetting collections and receipts from the public	181,811	205,600	239,842	240,364	238,998	247,130	254,753
TOTAL, User charges	**185,222**	**209,075**	**243,213**	**243,662**	**242,425**	**250,710**	**258,499**

III. USER CHARGE PROPOSALS

As shown in Table 18–3, the Administration is proposing new or increased user charges, including proposed extensions of expiring charges, that would increase collections by an estimated $3.5 billion in 2007, increasing to $9.7 billion in 2011. These amounts are collections and receipts only. They do not include related spending.

A. Discretionary User Charge Proposals

1. Offsetting collections

Department of Agriculture

Farm Service Agency (FSA) user fees. New discretionary user fees are proposed to partially offset the salaries and expense cost necessary to operate two programs at FSA. The first fee would apply a service fee to loan deficiency payments (LDP) to help defray the cost associated with agency site visits and application preparation. The fee is estimated to be $5 per LDP and would most likely be collected by taking the fee amount as a reduction from the total LDP payment prior to issuance. The second fee would also apply a service fee to conservation reserve program contracts (including re-enrollments and extensions) to help defray the cost associated with administration of the program. The fee would be determined by contract size and is estimated to average $100 per contract.

Department of Defense

Medical care fees. The Budget increases enrollment fees and deductibles for military retirees under age 65 (and families). The new cost shares differ for officer and enlisted retirees and for those in the different types of plans. They are also phased in over two years and indexed thereafter. The Budget also assumes that retail pharmacy co-payments for all military retirees will increase. In all cases, the changes in the out-of-pocket expenses would increase by no more than that of the annual Federal civilian health premium since 1996. None of these changes apply to active-duty members and their dependents. The total 2007 savings for these proposals is $735 million, $249 million of which requires new statutory authority.

Department of Health and Human Services

Medicare program management: Survey and certification user fee. The Budget proposes a new user fee for the Survey and Certification program within the Centers for Medicare and Medicaid Services. The agency would charge facilities participating in Medicare and Medicaid a fee for conducting follow-up surveys, which verify that they have taken appropriate action to correct identified deficiencies in compliance with specific Federal health, safety, and quality standards. This proposal could result in potential collections of $35 million in 2007.

Department of Homeland Security

Transportation Security Administration: Aviation security fees. Aviation security fees are levied on both passengers and air carriers. The Budget proposes to replace the two-tiered aviation passenger security fee with a single flat security fee of $5.00 for a one-way trip. The single fee corresponds better with actual security screening, which normally occurs only once in a one-way trip regardless of the number of trip segments. This proposal, along with air carrier security fees, will result in fee levels paid by system users that cover about 70 percent of core aviation security costs. Requiring users to pay for aviation screening and security is what was intended by the Congress and will free up other homeland resources to address security threats across the general population.

Table 18–3. USER FEE AND OTHER USER CHARGE PROPOSALS [1]

(estimated collections in millions of dollars)

	2007	2008	2009	2010	2011	2007–2011
DISCRETIONARY						
1. Offsetting collections						
Department of Agriculture						
Farm Service Agency user fees	35	34	34	33	34	170
Department of Defense						
Medical care fees	249	635	907	1,106	1,353	4,250
Department of Health and Human Services						
Medicare program management: Survey and certification user fee	35	34	34	33	34	170
Department of Homeland Security						
Transportation Security Administration: Aviation security fees	1,631	1,778	1,938	2,105	2,283	9,735
Department of Housing and Urban Development						
Office of Federal Housing Enterprise Oversight: Government-sponsored enterprise (GSE) regulation	–62	–60	–60	–59	–59	–300
Department of Justice						
Bureau of Alcohol, Tobacco, Firearms, and Explosives: Explosives regulation user fees	120	116	115	114	115	580
Department of Transportation						
St. Lawrence Seaway Development Corporation commercial tolls*	9	9	9	9	9	45
Department of Veterans Affairs						
Medical care fees:						
Prescription copayments for PL7s and 8s	288	255	255	255	254	1,307
Annual enrollment user fee for PL 7s and 8s	226	229	221	212	204	1,092
Eliminating offset of copayments with insurance collections for PL 7s and 8s	30	34	38	42	47	191
Commodity Futures Trading Commission						
Transaction fees	127	123	122	120	122	614
2. Offsetting receipts						
Department of the Interior						
Abandoned mine reclamation fees	312	79	....	....	....	391
Repeal Energy Bill fee prohibition	....	20	20	20	20	80
Subtotal, discretionary user charge proposals	3,000	3,286	3,633	3,990	4,416	18,325
MANDATORY						
1. Offsetting collections						
Depatment of Housing and Urban Development						
Government-sponsored enterprise (GSE) regulation	6	6	6	6	6	30
Federal Housing Enterprise Regulator						
Government-sponsored enterprise (GSE) regulation	98	98	98	98	98	490
Federal Housing Finance Board						
Government-sponsored enterprise (GSE) regulation	–36	–38	–39	–40	–41	–194
2. Offsetting receipts						
Department of Agriculture						
Food Safety and Inspection Service user fees*	105	155	148	151	154	713
Grain, Inspection, Packers, and Stockyards Administration (GIPSA) user fees*	20	20	21	21	22	104
Agricultural Marketing Service standardization and marketing orders user fees*	14	14	15	15	15	73
Animal and Plant Health Inspection Service user fees*	8	11	11	12	12	54
Federal crop insurance fees*	....	15	15	15	15	60
Department of Defense						
National defense stockpile asset sales: Authorization for additional sales	1	50	72	80	96	299
Department of Health and Human Services: Food and Drug Administration						
Re-inspection fees*	22	23	23	24	24	116
Food and animal feed export certification fees*	4	4	4	4	4	20
Department of Homeland Security						
Immigration examination fees	31	31	31	31	31	155
Department of the Interior						
Bureau of Land Management land sale authority	....	5	9	14	52	80
Arctic National Wildlife Refuge, lease bonuses:						
Collections for payments to Alaska	....	3,502	2	503	3	4,010
Collections deposited in the Treasury	....	3,502	2	503	3	4,010
Department of Labor						
Foreign labor certification fees	35	35	35	35	35	175
Pension Benefit Guaranty Corporation premiums	....	4,202	4,209	4,223	4,237	16,871
Department of the Treasury						
Alcohol and Tobacco Tax and Trade Bureau regulatory activity user fees*	29	29	29	29	29	145
Corps of Engineers—Civil Works						
Additional recreation fees	9	17	17	17	17	77
Environmental Protection Agency						
Pesticide user fees*	56	66	53	53	53	281
Pre-manufacture notifice user fees*	4	8	8	8	8	36

Table 18–3. USER FEE AND OTHER USER CHARGE PROPOSALS [1]—Continued

(estimated collections in millions of dollars)

	2007	2008	2009	2010	2011	2007–2011
Federal Communications Commission						
Authorize spectrum license fees	50	150	300	300	400	1,200
Subtotal, mandatory user charge proposals	456	11,905	5,069	6,102	5,273	28,805
GOVERNMENTAL RECEIPTS						
Department of the Interior						
National Indian Gaming Commission activity fees	....	5	5	5	5	20
Total, user charge proposals	**3,456**	**15,196**	**8,707**	**10,097**	**9,694**	**47,150**

Note: A negative sign indicates a decrease in collections.
[1] These amounts are collections and receipts only. They do not include related spending.
* Once the fees are enacted, the Administration will work to reclassify them to offset discretionary spending beginning in 2008.

Department of Housing and Urban Development

Office of Federal Housing Enterprise Oversight: Government-sponsored enterprise (GSE) regulation. This proposal is discussed below in the section on the Federal Housing Enterprise Regulator.

Department of Justice

Bureau of Alcohol, Tobacco, Firearms and Explosives: Explosives regulation user fees. A new discretionary explosives user fee is proposed for all explosives manufactured in or imported into the United States. The fee would not apply to smokeless and black powder. Nor would it apply to sales to the military. For 2007, a user fee of $0.02/ pound would generate an estimated $120 million in additional collections, which would be used to offset the cost of regulating the explosives industry.

Department of Transportation

St. Lawrence Seaway Development Corporation (SLSDC) commercial tolls. SLSDC is a wholly owned Government corporation and an operating administration of the Department of Transportation responsible for the operations and maintenance of the U.S. portion of the St. Lawrence Seaway between Montreal and Lake Erie. This Budget proposes to allow the SLSDC to collect commercial tolls from users of the Seaway. The proposal also provides some funding so that SLSDC could cover its full-year operational costs in 2007. In future years, the Seaway could be fully fee-funded, consistent with its Canadian counterpart.

Department of Veterans Affairs

Medical care fees. The President's Budget includes legislation to implement a $250 annual enrollment fee and higher drug co-pays (from $8 to $15) for non-disabled higher-income veterans (PL 7/8 veterans*)*. These proposals do not pertain to veterans who are considered among VA's core mission and the highest priority—those with service disabilities, lower incomes, or special needs. The Budget also includes technical correction language to ensure that current co-pays are charged to all eligible veterans equally and not reduced if a veteran has outside insurance. The total savings for 2007 is estimated to be $795 million, of which $544 million is increased collections.

Commodity Futures Trading Commission

Transaction fees. The Commodity Futures Trading Commission (CFTC) ensures the integrity and effectiveness of the U.S. futures and options markets and protects investors by preventing fraud and abuse and ensuring adequate disclosure of information. The Budget proposes a new transaction fee on commodity futures and option contracts traded on approved exchanges to cover the cost of the CFTC's regulatory activities. CFTC is the only Federal financial regulator that does not derive its funding from the specialized entities it regulates. This fee will shift CFTC's costs from the general taxpayer to the primary beneficiaries of CFTC's oversight and will be set at a level to avoid inhibiting the market's competitiveness.

2. *Offsetting receipts*

Department of the Interior

Abandoned mine reclamation fees. Collections from abandoned mine reclamation fees are allocated to States for reclamation grants. Current fees of 35 cents per ton for surface mined coal, 15 cents per ton for underground mined coal, and 10 cents per ton for lignite coal are scheduled to expire on June 30, 2005. Abandoned land problems are expected to exist in certain States after all the money from the collection of fees under current law is expended. The Administration proposes to extend these fees through 2007.

Repeal Energy Bill fee prohibition. A last-minute addition to the 2005 Energy Policy Act prohibited the Administration from implementing new fees for oil and gas permit processing on Federal lands and provided a mandatory stream of funding for permit processing from funds that previously went to the Treasury. The Budget proposes to repeal this provision and institute new fees, as had been proposed in the 2006 Budget. The proposed fees are expected to generate approximately $20 million in 2008, thereby reducing the cost to taxpayers for operating these programs and eliminating the need for mandatory funding.

B. Mandatory User Charge Proposals

1. Offsetting collections

Department of Housing and Urban Development (HUD)

Government-sponsored enterprise (GSE) regulation. Upon enactment of the Budget proposal for a strengthened regulator for GSE's it is expected that the cost of HUD's responsibilities under the Federal Housing Enterprise Safety and Soundness Act of 1992, and amendments as proposed, would be assessed on Fannie Mae and Freddie Mac. These responsibilities include the establishment and enforcement of affordable housing goals for the GSEs, ensuring GSE compliance with fair housing laws, and providing consultation to the safety and soundness regulator on the GSEs' new activities. The cost of these regulatory responsibilities is currently in the HUD salaries and expenses account as a non-reimbursable expense.

Federal Housing Enterprise Regulator

Government-sponsored enterprise (GSE) regulation. The Administration will again propose broad reform of the supervisory system for GSEs in the housing market. Fees currently collected by the Office of Federal Housing Enterprise Oversight and the Federal Housing Finance Board would instead be collected by a new housing GSE safety and soundness regulator. For additional information, see Chapter 7, "Credit and Insurance", in this volume.

Federal Finance Housing Board

Government-sponsored enterprise (GSE) regulation. This proposal is discussed above in the section on the Federal Housing Enterprise Regulator.

2. Offsetting receipts

For the mandatory proposals noted with an asterisk (*) in the text below and in Table 18–3, the Administration will work with Congress to reclassify the enacted fees as discretionary beginning in 2008. Once reclassified, the Administration proposes to offset these fees against discretionary spending. Discretionary totals in those years will be reduced by these fees.

Department of Agriculture

*Food Safety and Inspection Service user fees.** The Administration proposes a new user fee for the Food Safety and Inspection Service (FSIS). Under the proposed fee, the meat, poultry and egg industries would be required to reimburse the Federal Government for the full cost of extra shifts for inspection services. FSIS would cover the cost of a primary eight hour shift and the establishments would pay for additional complete work shifts. Currently, establishments pay for overtime when it is less than one complete shift.

*Grain Inspection, Packers, and Stockyards Administration (GIPSA) user fees.** The Administration proposes to establish a fee to cover the cost associated with GIPSA's standardization activities and a licensing fee to cover the cost associated with administering meat packers and stockyards activities.

*Agriculture Marketing Service (AMS) standardization and marketing orders user fees.** The Administration is proposing two fees for the AMS. The first is a mandatory user fee (spending will be discretionary) to recover the full cost of the development of grade standards for which the agency currently provides grading services. The second is a proposal to recover a majority of the cost of the agency's oversight of marketing agreements and orders programs. These programs are industry run "self-help" initiatives and funding for Federal oversight of these programs should come from the industries that benefit substantially from their operation.

*Animal and Plant Health Inspection Service user fees.** The Administration proposes to establish user fees for animal welfare inspections, for animal research facilities, carriers, and in-transit handlers of animals.

*Federal crop insurance fees.** The Administration proposes to implement a participation fee in the Federal crop insurance program to fund modernization and future maintenance of the existing information technology (IT) system. The fee would be charged to insurance companies participating in the Federal crop insurance program based on a rate of about one-half cent per dollar of premium sold. Because it is the companies that will most benefit from better, more advanced computer systems, it is reasonable that they contribute to the modernization and maintenance of these systems.

Department of Defense

National Defense stockpile asset sales: Authorization for additional sales. The Administration proposes legislation to permit the sale of the remaining government-owned industrial commodities in the National Defense Stockpile that are not needed for national defense requirements. Sales of these commodities are expected to result in mandatory sales receipts of about $1 million in 2007 and a total of about $347 million in the next ten years. Sales receipts are subject to fluctuation based on commodity price changes.

Department of Health and Human Services: Food and Drug Administration (FDA)

*Re-inspection fees.** FDA conducts post-market inspections of food, human drug, biologic, animal drug and feed, and medical device manufacturers to assess their compliance with Good Manufacturing Practice requirements. The Administration proposes new fees that would be assessed for repeat inspections due to violations found during the first inspection. FDA estimates collections of $22 million in 2007.

*Food and animal feed export certification fees.** FDA collects user fees for the issuance of export certifications for human and animal drugs, and medical devices as authorized by the Federal Food, Drug, and Cosmetic Act. The Administration proposes to expand FDA's authority to collect user fees for the issuance of export certificates for foods and animal feed. Timely issuance of food/feed export certificates funded through user fees would improve the ability of food and animal feed producers to export their products. Thus, this proposal would enhance global competitiveness of U.S. industry. FDA estimates collections of $4 million in 2007.

Department of Homeland Security

Extend Customs and Border Protection user fees. The Administration proposes the reauthorization beginning in 2015 of two user fees set to expire at the end of 2014: U.S Customs and Border Protection (CBP) conveyance and passenger fees, and the Merchandise Processing Fee (MPF). CBP currently collects multiple different conveyance and passenger user fees under the Consolidated Omnibus Budget Reconciliation Act of 1985 and related statues and a merchandise processing fee (MPF) established by the Omnibus Budget Reconciliation Act of 1986, all of which are set to expire on September 30, 2014. Collections in 2015 are estimated to be $2.9 billion.

Immigration examination fees. The Administration proposes to adjust fees for Temporary Protected Status applications to fully capture processing costs and allow the Department to charge premium service fees for certain adjudications.

Department of the Interior

Bureau of Land Management land sale authority. The Administration will propose legislation to amend BLM's land sale authority under the Federal Land Transaction Facilitation Act (FLTFA) to: (1) allow BLM to use updated management plans to identify areas suitable for disposal; (2) allow a portion of the receipts to be used by BLM for restoration projects; (3) return 70 percent of land sale proceeds to the Treasury; and (4) cap receipt retention at $60 million per year. BLM is currently limited to selling lands that had been identified for disposal in land use plans that were in effect prior to enactment of FLTFA. Use of the receipts is currently limited to the purchase of other lands for conservation purposes. The new receipts shown in this chapter reflect only a portion of the savings from this proposal; additional savings will be generated by redirecting receipts under the existing FLFTA authority to the Treasury. The amounts shown in Table 18–3 reflect receipts only and do not include related spending.

Arctic National Wildlife Refuge: Collections for payments to Alaska and Federal receipts. The Budget includes a proposal to authorize the Department of the Interior to conduct environmentally responsible oil and gas exploration and development within a small area of the Arctic National Wildlife Refuge, sometimes referred to as the "1002 Area," located in northern Alaska. The Department of the Interior estimates that recoverable oil from this area is between 5.7 and 16 billion barrels. The Budget assumes that the first oil and gas lease sale would be held in 2008 and would result in an estimated $7 billion in new revenues. All oil and gas revenues from the 1002 Area would be shared fifty percent with the State of Alaska, including the estimated $6 million in annual rental payments. The Federal share of revenues would be deposited in the Treasury.

Department of Labor

Foreign labor certification fees. The Administration will propose legislation to establish a cost-based user fee for new applications under the permanent labor certification program. Fee proceeds would offset the costs of administering the program. Upon enactment of the fee, funding for these activities now included in the program administration account will be reviewed and adjusted.

Pension Benefit Guaranty Corporation premiums. The Administration will re-propose increases to the insurance premiums paid to the Pension Benefit Guaranty Corporation for single-employer defined benefit pension insurance. The increase in premiums is needed to eliminate over the next 10 years the nearly $23 billion deficit in this system. The Administration is working with the Congress to enact comprehensive pension reform including funding, disclosure, and premium changes, to ensure the solvency of the pension system.

Department of the Treasury

*Alcohol and Tobacco Tax and Trade Bureau regulatory activity user fees.** The Budget proposes to establish user fees to cover the costs of the Tax and Trade Bureau's regulatory functions under its "Protect the Public" line-of-business. The new user fees include filing fees for Certificate of Label Approvals, proposed formulas, permit applications, and administrative fees for "drawbacks" from manufacturers of non-beverage products.

Corps of Engineers—Civil Works

Additional recreation fees. The Corps of Engineers manages 4,300 recreation areas at 465 Corps projects (mostly lakes and reservoirs) on 12 million acres in 43 States at an annual cost of about $267 million. The Administration re-proposes a recreation modernization ("RecMod") initiative that would encourage the collection of entrance fees (not currently authorized) and the creation of public/private partnerships to improve Corps recreation facilities and services at little or no cost to the Federal Government. User fees and private/public partnerships would be implemented selectively, at recreation areas where fees would be appropriate. Some Corps recreation areas are isolated and remote; raising fees there might not be productive. But others are integral parts of prosperous urban communities with valuable lake-front property. Those communities may decide to help upgrade the Corps recreation areas that their citizens enjoy to provide amenities that might not otherwise be available.

Environmental Protection Agency

*Pesticide user fees.** EPA presently collects fees from entities seeking to register their pesticides and from entities with existing pesticides registered for use in the United States. The Administration proposes to better cover the costs of EPA's pesticide services by increasing collections of currently authorized, but soon to expire, pesticide user fees. Furthermore, the Federal

Food, Drug, and Cosmetic Act requires EPA to collect fees for the establishment and reassessment of pesticide tolerances. However, collection of these fees has been blocked through 2008. The Administration proposes to eliminate the prohibition and collect the tolerance fee in 2007. In addition, amendments to the Federal Insecticide, Fungicide, and Rodenticide Act require EPA to implement a new program to review all registered pesticides on a 15 year cycle to ensure that registrations reflect current science. EPA will phase in this new Registration Review program in 2007 while phasing out its Reregistration program. If EPA determines that a pesticide adversely impacts an endangered species during registration review, additional work is required to ensure adequate protections are implemented. The new registration review fee structure is designed to cover the incremental cost of this work.

*Pre-manufacture notice user fees.** EPA presently collects fees from chemical manufacturers seeking to bring new chemicals into commerce. These fees are authorized by the Toxic Substances Control Act and are subject to an outdated statutory cap. The Administration proposes to eliminate the cap so that EPA can recover a greater portion of the cost of the program.

Federal Communications Commission

Authorize spectrum license fees. To promote efficient spectrum use, the Administration proposes new authority for the FCC to set user fees on unauctioned spectrum licenses, based on public-interest and spectrum-management principles. Fee collections are proposed to begin in 2007 and are estimated to total $3.6 billion through 2016.

Extend spectrum auction authority. The Administration proposes to extend indefinitely the FCC's authority to auction spectrum licenses, which was slated to expire in 2007, but is extended through 2011 in the Deficit Reduction Act. Assuming that this temporary extension occurs, the additional receipts from a permanent extension are estimated to be $1.0 billion for 2012–2016.

C. User Charge Proposals that are Governmental Receipts

Department of the Interior

National Indian Gaming Commission activity fees. The National Indian Gaming Commission regulates and monitors gaming operations conducted on Indian lands. Since 1998, there has been a fixed cap on the annual fees the Commission may assess gaming operations to cover the costs of its oversight responsibilities. The Administration proposes to amend the current fee structure so that the Commission can adjust its activities to the growth in the Indian gaming industry.

OTHER OFFSETTING COLLECTIONS AND RECEIPTS

Table 18–4 shows the distribution of user charges and other offsetting collections and receipts according to whether they are offsetting collections credited to expenditure accounts or offsetting receipts. The table shows that total offsetting collections and receipts from the public are estimated to be $312.9 billion in 2007. Of these, an estimated $165.5 billion are offsetting collections credited to expenditure accounts and an estimated $147.4 billion are deposited in offsetting receipt accounts.

Information on the user charges presented in Table 18–4 is available in Tables 18–2 and 18–3 and the discussion that accompanies those tables. Major offsetting collections deposited in expenditure accounts that are not user charges include collections by the Commodity Credit Corporation fund in the Department of Agriculture, which are related to loans; collections from States to supplement payments in the supplemental security income program; and pre-credit reform loan repayments. Major offsetting receipts that are not user charges include military assistance program sales and interest income.

Table 18–5 includes all offsetting receipts deposited in receipt accounts. These include payments from one part of the Government to another, called intragovernmental transactions, and collections from the public. These receipts are offset (deducted) from outlays in the Federal budget. In total, offsetting receipts are estimated to be $718.3 billion in 2007: $570.8 billion are intragovernmental transactions; and $147.4 billion are from the public, shown in the table as proprietary receipts from the public ($130.8 billion) and offsetting governmental receipts ($16.7 billion).

As noted above, offsetting collections and receipts by agency are also displayed in Table 21–1, which appears in Chapter 21, "Outlays to the Public, Gross and Net," of this volume.

Table 18–4. OFFSETTING COLLECTIONS AND RECEIPTS FROM THE PUBLIC

(in millions of dollars)

	Actual 2005	Estimate	
		2006	2007
Offsetting collections credited to expenditure accounts:			
User charges:			
Postal service stamps and other postal fees	68,504	71,176	71,491
Defense Commissary Agency	5,393	5,296	5,294
Employee contributions for employees and retired employees health benefits funds	8,403	9,082	9,826
Sale of energy:			
Tennessee Valley Authority	7,806	8,621	8,937
Bonneville Power Administration	3,214	3,134	3,436
All other user charges	26,783	33,700	37,523
Subtotal, user charges	120,103	131,009	136,507
Other collections credited to expenditure accounts:			
Commodity Credit Corporation fund	11,059	14,751	13,047
Supplemental security income (collections from the States)	4,506	4,240	4,561
Other collections	16,057	11,737	11,340
Subtotal, other collections	31,622	30,728	28,948
Subtotal, collections credited to expenditure accounts	151,725	161,737	165,455
Offsetting receipts:			
User charges:			
Medicare premiums	38,243	48,119	55,478
Outer Continental Shelf rents, bonuses, and royalties	6,146	9,118	9,541
All other user charges	17,319	17,354	38,316
Subtotal, user charges deposited in receipt accounts	61,708	74,591	103,335
Other collections deposited in receipt accounts:			
Military assistance program sales	11,051	11,114	11,044
Interest income	15,168	14,003	15,203
All other collections deposited in receipt accounts	16,957	22,978	17,847
Subtotal, other collections deposited in receipt accounts	43,176	48,095	44,094
Subtotal, collections deposited in receipt accounts	104,884	122,686	147,429
Total, offsetting collections and receipts from the public	**256,609**	**284,423**	**312,884**
Total, offsetting collections and receipts excluding off-budget	**188,042**	**213,187**	**241,332**
ADDENDUM:			
User charges that are offsetting collections and receipts [1]	181,811	205,600	239,842
Other offsetting collections and receipts from the public	74,798	78,823	73,042
Total, offsetting collections and receipts from the public	**256,609**	**284,423**	**312,884**

[1] Excludes user charges that are classified on the receipts side of the budget. For total user charges, see Table 18–1 or Table 18–2.

Table 18–5. OFFSETTING RECEIPTS BY TYPE

(In millions of dollars)

Source	2005 Actual	Estimate 2006	2007	2008	2009	2010	2011
INTRAGOVERNMENTAL TRANSACTIONS							
On-budget receipts:							
Federal intrafund transactions:							
Distributed by agency:							
Interest from the Federal Financing Bank	552	393	786	803	697	742	794
Interest on Government capital in enterprises	814	1,073	1,075	1,075	1,066	1,023	1,004
Interest received by retirement and health benefits funds	180	172	177	184	190	202	217
General fund payments to retirement and health benefits funds:							
Proposed Legislation (non-PAYGO)	....	1,713	1,999	2,353	2,599	2,966	3,377
DoD retiree health care fund	17,639	19,216	20,722	22,723	24,903	27,264	29,806
Proposed Legislation (non-PAYGO)	....	....	–2	–7	–11	–17	–22
Miscellaneous Federal retirement funds	277	285	285	306	377	474	437
Other	3,323	2,551	2,789	2,305	2,356	2,409	2,474
Proposed Legislation (non-PAYGO)	....	28	105	270	463	682	932
Undistributed by agency:							
Employing agency contributions:							
Proposed Legislation (non-PAYGO)	....	2,933	3,138	3,358	3,593	3,845	4,114
DoD retiree health care fund	10,490	11,072	11,546	12,125	12,824	13,601	14,410
Proposed Legislation (non-PAYGO)	....	....	–73	–77	–82	–87	–92
Total Federal intrafunds	33,275	39,436	42,547	45,418	48,975	53,104	57,451
Trust intrafund transactions:							
Distributed by agency:							
Payments to railroad retirement	4,726	4,900	6,576	6,793	6,911	7,048	6,896
Total trust intrafunds	4,726	4,900	6,576	6,793	6,911	7,048	6,896
Total intrafund transactions	38,001	44,336	49,123	52,211	55,886	60,152	64,347
Interfund transactions:							
Distributed by agency:							
Federal fund payments to trust funds:							
Contributions to insurance programs:							
Military retirement fund	21,358	23,180	24,049	24,951	25,886	26,857	27,865
Supplementary medical insurance	115,201	166,163	196,398	206,351	214,063	224,482	241,768
Proposed Legislation (non-PAYGO)	....	....	–466	–2,159	–3,284	–3,871	–4,405
Hospital insurance	9,381	10,689	12,206	14,001	15,347	15,953	18,146
Railroad social security equivalent fund	119	123	135	154	157	162	185
Rail industry pension fund	323	313	323	338	352	366	381
Civilian supplementary retirement contributions	25,887	27,453	27,815	28,428	29,105	29,688	30,108
Unemployment insurance	773	768	794	813	823	846	960
Other contributions	526	776	743	710	619	595	585
Subtotal	173,568	229,465	261,997	273,587	283,068	295,078	315,593
Miscellaneous payments	2,072	1,751	1,724	1,672	1,654	1,621	1,629
Proposed Legislation (non-PAYGO)	....	....	2,734	....	....	....	....
Subtotal	175,640	231,216	266,455	275,259	284,722	296,699	317,222
Trust fund payments to Federal funds:							
Quinquennial adjustment for military service credits	....	350	....	....	....	....	....
Other	3,305	1,744	3,046	3,542	3,604	3,667	3,730
Proposed Legislation (non-PAYGO)	....	....	2,282	–450	–453	–461	–470
Subtotal	3,305	2,094	5,328	3,092	3,151	3,206	3,260
Total interfunds distributed by agency	178,945	233,310	271,783	278,351	287,873	299,905	320,482
Undistributed by agency:							
Employer share, employee retirement (on-budget):							
Civil service retirement and disability insurance	13,059	13,346	14,365	15,489	16,522	17,638	18,816
CSRDI from Postal Service	4,382	4,512	4,632	4,732	4,882	4,930	4,990
Hospital insurance (contribution as employer) [1]	2,630	2,734	2,782	2,858	2,920	3,009	3,130
Postal employer contributions to FHI	672	682	706	732	759	788	818
Military retirement fund	16,554	15,999	15,625	15,765	16,167	16,652	17,167

Table 18–5. OFFSETTING RECEIPTS BY TYPE—Continued

(In millions of dollars)

Source	2005 Actual	Estimate					
		2006	2007	2008	2009	2010	2011
Other Federal employees retirement	190	191	193	195	197	199	201
Total employer share, employee retirement (on-budget)	37,487	37,464	38,303	39,771	41,447	43,216	45,122
Interest received by on-budget trust funds	69,153	71,756	75,346	79,012	83,242	86,881	89,765
Proposed Legislation (non-PAYGO)	....	....	73	221	461	769	1,140
Total interfund transactions undistributed by agency	106,640	109,220	113,722	119,004	125,150	130,866	136,027
Total interfund transactions	285,585	342,530	385,505	397,355	413,023	430,771	456,509
Total on-budget receipts	323,586	386,866	434,628	449,566	468,909	490,923	520,856
Off-budget receipts:							
Trust intrafund transactions:							
Distributed by agency:							
Interfund transactions:							
Distributed by agency:							
Federal fund payments to trust funds:							
Old-age, survivors, and disability insurance	16,517	16,379	18,310	21,362	22,091	23,762	27,442
Undistributed by agency:							
Employer share, employee retirement (off-budget)	10,941	11,677	12,161	12,832	13,459	14,179	15,040
Interest received by off-budget trust funds	91,836	97,443	105,748	115,701	127,788	140,427	154,322
Proposed Legislation (non-PAYGO)	....	....	....	....	....	–670	–2,976
Total off-budget receipts:	119,294	125,499	136,219	149,895	163,338	177,698	193,828
Total intragovernmental transactions	**442,880**	**512,365**	**570,847**	**599,461**	**632,247**	**668,621**	**714,684**
PROPRIETARY RECEIPTS FROM THE PUBLIC							
Distributed by agency:							
Interest:							
Interest on foreign loans and deferred foreign collections	418	402	426	341	339	337	334
Interest on deposits in tax and loan accounts	510	602	622	628	640	643	643
Other interest (domestic—civil) [2]	11,135	12,129	12,815	13,502	14,094	14,658	16,214
Total interest	12,063	13,133	13,863	14,471	15,073	15,638	17,191
Dividends and other earnings	3,105	870	1,340	1,382	1,400	1,400	1,378
Royalties and rents	3,495	5,004	4,682	4,636	4,320	4,127	4,172
Proposed Legislation (PAYGO)	....	....	–50	–51	–50	–50	–50
Sale of products:							
Sale of timber and other natural land products	256	260	305	273	287	293	299
Sale of minerals and mineral products	63	753	94	36	33	32	31
Sale of power and other utilities	874	661	734	792	822	790	795
Other	107	102	92	109	105	94	113
Total sale of products	1,300	1,776	1,225	1,210	1,247	1,209	1,238
Fees and other charges for services and special benefits:							
Medicare premiums and other charges (trust funds)	38,243	48,119	55,585	60,141	63,264	65,811	69,407
Proposed Legislation (PAYGO)	....	....	–107	–445	–481	–467	–407
Nuclear waste disposal revenues	736	752	754	767	767	769	771
Veterans life insurance (trust funds)	171	162	146	132	120	107	96
Other [2]	3,786	9,729	11,779	12,273	13,004	13,803	14,692
Proposed Legislation (non-PAYGO)	....	....	256	281	274	266	260
Proposed Legislation (PAYGO)	....	....	266	356	354	358	362
Total fees and other charges	42,936	58,762	68,679	73,505	77,302	80,647	85,181
Sale of Government property:							
Sale of land and other real property [2]	1,333	999	988	986	954	952	915
Proposed Legislation (PAYGO)	....	....	48	278	155	101	118
Military assistance program sales (trust funds)	11,051	11,114	11,044	11,243	11,446	11,651	11,861
Other	324	146	71	74	77	77	71
Proposed Legislation (PAYGO)	....	....	1	50	72	80	96

Table 18–5. OFFSETTING RECEIPTS BY TYPE—Continued

(In millions of dollars)

Source	2005 Actual	Estimate					
		2006	2007	2008	2009	2010	2011
Total sale of Government property	12,708	12,259	12,152	12,631	12,704	12,861	13,061
Realization upon loans and investments:							
Negative subsidies and downward reestimates	5,839	7,992	875	832	810	786	782
Proposed Legislation (non-PAYGO)	....	....	676	880	939	1,039	1,171
Repayment of loans to foreign nations	263	108	25	28	30	33	36
Other	1,385	72	70	67	80	80	80
Total realization upon loans and investments	7,487	8,172	1,646	1,807	1,859	1,938	2,069
Recoveries and refunds [2]	7,513	5,160	5,398	5,163	4,994	5,093	4,965
Proposed Legislation (non-PAYGO)	....	....	288	313	379	384	389
Proposed Legislation (PAYGO)	....	....	9	499	537	393	405
Miscellaneous receipt accounts [2]	2,508	2,230	2,242	2,173	2,186	2,207	2,227
Proposed Legislation (PAYGO)	....	....	23	23	23	23	23
Total proprietary receipts from the public distributed by agency	93,115	107,366	111,497	117,762	121,974	125,870	132,249
Undistributed by agency:							
Rents, bonuses, and royalties:							
Outer Continental Shelf rents and bonuses	679	707	949	1,075	1,058	846	756
Outer Continental Shelf royalties	5,467	8,411	8,542	8,159	8,048	7,932	7,997
Proposed Legislation (PAYGO)	....	....	50	50	50	50	50
Arctic National Wildlife Refuge:							
Proposed Legislation (PAYGO)	....	....	....	7,004	4	1,006	6
Sale of major assets	....	....	....	323	....	....	....
Other undistributed offsetting receipts	....	....	9,720	1,080	....	....	....
Total proprietary receipts from the public undistributed by agency	6,146	9,118	19,261	17,691	9,160	9,834	8,809
Total proprietary receipts from the public	**99,261**	**116,484**	**130,758**	**135,453**	**131,134**	**135,704**	**141,058**
OFFSETTING GOVERNMENTAL RECEIPTS							
Distributed by agency:							
Defense cooperation	11	12	13	14	15	16	17
Regulatory fees	5,341	5,925	6,471	6,401	6,531	6,738	6,990
Proposed Legislation (non-PAYGO)	....	....	–62	–60	–60	–59	–59
Proposed Legislation (PAYGO)	....	....	66	66	66	66	66
Other	111	155	157	158	161	163	132
Proposed Legislation (PAYGO)	....	....	26	27	27	28	28
Undistributed by agency:							
Spectrum auction proceeds	160	110	9,950	12,238	2,870	100	100
Proposed Legislation (PAYGO)	....	....	50	150	300	300	400
Total offsetting governmental receipts	**5,623**	**6,202**	**16,671**	**18,994**	**9,910**	**7,352**	**7,674**
Total offsetting receipts	**547,764**	**635,051**	**718,276**	**753,908**	**773,291**	**811,677**	**863,416**

[1] Includes provision for covered Federal civilian employees and military personnel.
[2] Includes both Federal funds and trust funds.

19. TAX EXPENDITURES

The Congressional Budget Act of 1974 (Public Law 93–344) requires that a list of "tax expenditures" be included in the budget. Tax expenditures are defined in the law as "revenue losses attributable to provisions of the Federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of liability." These exceptions may be viewed as alternatives to other policy instruments, such as spending or regulatory programs. Identification and measurement of tax expenditures depends importantly on the baseline tax system against which the actual tax system is compared.

The largest reported tax expenditures tend to be associated with the individual income tax. For example, sizeable deferrals, deductions and exclusions are provided for employer contributions for medical insurance, pension contributions and earnings, capital gains, and payments of State and local individual income and property taxes. Reported tax expenditures under the corporate income tax tend to be related to timing differences in the rate of cost recovery for various investments. As is discussed below, the extent to which these provisions are classified as tax expenditures varies according to the conceptual baseline used.

Each tax expenditure estimate in this chapter was calculated assuming other parts of the tax code remained unchanged. The estimates would be different if all tax expenditures or major groups of tax expenditures were changed simultaneously because of potential interactions among provisions. For that reason, this chapter does not present a grand total for the estimated tax expenditures. Moreover, past tax changes entailing broad elimination of tax expenditures were generally accompanied by changes in tax rates or other basic provisions, so that the net effects on Federal revenues were considerably (if not totally) offset.

Tax expenditures relating to the individual and corporate income taxes are estimated for fiscal years 2005–2011 using two methods of accounting: revenue effects and present values. The present value approach provides estimates of the revenue effects for tax expenditures that generally involve deferrals of tax payments into the future.

The section of the chapter on performance measures and economic effects presents information related to assessment of the effect of tax expenditures on the achievement of program performance goals. This section is a complement to the Government-wide performance plan required by the Government Performance and Results Act of 1993.

The 2004, 2005, and 2006 Budgets included a thorough review of important ambiguities in the tax expenditure concept. In particular, this review focused on defining tax expenditures relative to a comprehensive income tax baseline, defining tax expenditures relative to a broad-based consumption tax baseline, and defining negative tax expenditures, i.e., provisions of current law that over-tax certain items or activities. A similar review is presented in the Appendix again this year.

TAX EXPENDITURES IN THE INCOME TAX

Tax Expenditure Estimates

All tax expenditure estimates presented here are based upon current tax law enacted as of December 31, 2005. Expired or repealed provisions are not listed if their revenue effects result only from taxpayer activity occurring before fiscal year 2005. Due to the time required to estimate the large number of tax expenditures, the estimates are based on Mid-Session economic assumptions; exceptions are the earned income tax credit and child credit provisions, which involve outlay components and hence are updated to reflect the economic assumptions used elsewhere in the Budget.

The total revenue effects for tax expenditures for fiscal years 2005–2011 are displayed according to the Budget's functional categories in Table 19–1. Descriptions of the specific tax expenditure provisions follow the tables of estimates and the discussion of general features of the tax expenditure concept.

As in prior years, two baseline concepts, the normal tax baseline and the reference tax law baseline, are used to identify income tax expenditures. These baseline concepts are thoroughly discussed in Special Analysis G of the 1985 Budget, where the former is referred to as the pre-1983 method and the latter the post-1982 method. For the most part, the two concepts coincide. However, items treated as tax expenditures under the normal tax baseline, but not the reference tax law baseline, are indicated by the designation "normal tax method" in the tables. The revenue effects for these items are zero using the reference tax rules. The alternative baseline concepts are discussed in detail following the tables.

Table 19–2 reports the respective portions of the total revenue effects that arise under the individual and corporate income taxes separately. The location of the estimates under the individual and corporate headings does not imply that these categories of filers benefit from the special tax provisions in proportion to the respective tax expenditure amounts shown. Rather, these breakdowns show the specific tax accounts through which the various provisions are cleared. The ultimate beneficiaries of corporate tax expenditures could be shareholders, employees, customers, or other providers of capital, depending on economic forces.

Table 19–3 ranks the major tax expenditures by the size of their 2007–2011 revenue effect. Outlay Equivalent Estimates of Income Tax Expenditures, which were included in prior volumes of Analytical Perspectives, are no longer included in this chapter.[1]

Interpreting Tax Expenditure Estimates

The estimates shown for individual tax expenditures in Tables 19–1, 19–2, and 19–3 do not necessarily equal the increase in Federal revenues (or the change in the budget balance) that would result from repealing these special provisions, for the following reasons:

First, eliminating a tax expenditure may have incentive effects that alter economic behavior. These incentives can affect the resulting magnitudes of the activity or of other tax provisions or Government programs. For example, if capital gains were taxed at ordinary rates, capital gain realizations would be expected to decline, potentially resulting in a decline in tax receipts. Such behavioral effects are not reflected in the estimates.

Second, tax expenditures are interdependent even without incentive effects. Repeal of a tax expenditure provision can increase or decrease the tax revenues associated with other provisions. For example, even if behavior does not change, repeal of an itemized deduction could increase the revenue costs from other deductions because some taxpayers would be moved into higher tax brackets. Alternatively, repeal of an itemized deduction could lower the revenue cost from other deductions if taxpayers are led to claim the standard deduction instead of itemizing. Similarly, if two provisions were repealed simultaneously, the increase in tax liability could be greater or less than the sum of the two separate tax expenditures, because each is estimated assuming that the other remains in force. In addition, the estimates reported in Table 19–1 are the totals of individual and corporate income tax revenue effects reported in Table 19–2 and do not reflect any possible interactions between individual and corporate income tax receipts. For this reason, the estimates in Table 19–1 should be regarded as approximations.

[1] The Administration has dropped the estimates of the outlay equivalents because they were often the same as the normal tax expenditure estimates, and the criteria for applying the concepts as to when they should differ were often judgmental and hard to apply with consistency across time and across tax expenditure items.

Table 19–1. ESTIMATES OF TOTAL INCOME TAX EXPENDITURES
(in millions of dollars)

		Total from corporations and individuals							
		2005	2006	2007	2008	2009	2010	2011	2007–11
	National Defense								
1	Exclusion of benefits and allowances to armed forces personnel	2,990	3,020	3,050	3,070	3,110	3,140	3,170	15,390
	International affairs:								
2	Exclusion of income earned abroad by U.S. citizens	2,750	2,810	2,940	3,100	3,270	3,450	3,640	16,400
3	Exclusion of certain allowances for Federal employees abroad	900	950	1,000	1,050	1,100	1,160	1,230	5,540
4	Extraterritorial income exclusion	5,220	4,370	1,720	110	50	50	40	1,970
5	Inventory property sales source rules exception	1,560	1,680	1,840	2,040	2,230	2,380	2,540	11,030
6	Deferral of income from controlled foreign corporations (normal tax method)	10,500	11,160	11,940	12,770	13,650	14,600	15,620	68,580
7	Deferred taxes for financial firms on certain income earned overseas	2,190	2,260	960	....	....	....	....	960
	General science, space, and technology:								
8	Expensing of research and experimentation expenditures (normal tax method)	4,110	7,920	6,990	6,260	5,360	4,800	4,840	28,250
9	Credit for increasing research activities	5,160	2,160	920	390	180	50	....	1,540
	Energy:								
10	Expensing of exploration and development costs, fuels	390	680	870	830	650	500	380	3,230
11	Excess of percentage over cost depletion, fuels	590	670	690	660	640	620	620	3,230
12	Alternative fuel production credit	2,320	2,390	2,460	990	....	....	....	3,450
13	Exception from passive loss limitation for working interests in oil and gas properties	40	40	40	40	40	40	40	200
14	Capital gains treatment of royalties on coal	90	90	90	100	70	60	80	400
15	Exclusion of interest on energy facility bonds	80	90	90	100	100	110	110	510
16	Enhanced oil recovery credit	300	....	....	....	....	....	20	20
17	New technology credit	240	510	690	800	850	860	860	4,060
18	Alcohol fuel credits [1]	40	40	40	50	50	60	30	230
19	Tax credit and deduction for clean-fuel burning vehicles	70	90	200	140	140	–20	–40	420
20	Exclusion of utility conservation subsidies	80	80	80	80	80	70	70	380
21	Credit for holding clean renewable energy bonds	....	....	10	30	40	50	50	180
22	Deferral of gain from dispositions of transmission property to implement FERC restructuring policy	490	620	530	230	–100	–360	–510	–210
23	Credit for production from advanced nuclear power facilities	....	....	....	....	....	....	....	....
24	Credit for investment in clean coal facilities	....	50	50	100	150	200	280	780
25	Temporary 50% expensing for equipment used in the refining of liquid fuels	....	10	30	120	240	260	180	830
26	Pass through low sulfur diesel expensing to cooperative owners	40	....	–10	....	–10	....	–10	–30
27	Natural gas distribution pipelines treated as 15–year property	....	20	50	90	120	150	150	560
28	Amortize all geological and geophysical expenditures over 2 years	....	40	150	180	140	100	60	630
29	Allowance of deduction for certain energy efficient commercial building property	....	80	190	140	30	–10	–10	340
30	Credit for construction of new energy efficient homes	....	10	20	10	10	....	....	40
31	Credit for energy efficiency improvements to existing homes	....	220	380	150	....	....	....	530
32	Credit for energy efficient appliances	....	120	80	....	....	....	....	80
33	30% credit for residential purchases/installations of solar and fuel cells	....	10	10	10	....	....	....	20
34	Credit for business installation of qualified fuel cells and stationary microturbine power plants	....	80	130	50	–10	–10	–10	150
35	Alternative Fuel and Fuel Mixture tax credit	150	170	....	....	....	....	....	....
	Natural resources and environment:								
36	Expensing of exploration and development costs, nonfuel minerals	....	....	....	....	....	....	....	....
37	Excess of percentage over cost depletion, nonfuel minerals	270	280	300	310	310	330	340	1,590
38	Exclusion of interest on bonds for water, sewage, and hazardous waste facilities	450	480	500	550	580	600	620	2,850
39	Capital gains treatment of certain timber income	90	90	90	100	70	60	80	400
40	Expensing of multiperiod timber growing costs	350	370	380	400	410	430	430	2,050
41	Tax incentives for preservation of historic structures	350	370	380	400	420	440	470	2,110
42	Expensing of capital costs with respect to complying with EPA sulfur regulations	10	10	10	30	50	30	....	120
43	Exclusion of gain or loss on sale or exchange of certain brownfield sites	....	....	10	30	40	70	60	210
	Agriculture:								
44	Expensing of certain capital outlays	110	130	130	130	140	140	150	690
45	Expensing of certain multiperiod production costs	60	70	70	80	80	80	90	400
46	Treatment of loans forgiven for solvent farmers	10	10	10	10	10	10	10	50
47	Capital gains treatment of certain income	880	870	900	1,050	750	590	780	4,070
48	Income averaging for farmers	40	40	40	40	40	40	50	210
49	Deferral of gain on sale of farm refiners	10	10	20	20	20	20	20	100
50	Bio-Diesel and small agri-biodiesel producer tax credits	30	90	100	90	40	20	20	270
	Commerce and housing:								
	Financial institutions and insurance:								
51	Exemption of credit union income	1,290	1,370	1,450	1,540	1,640	1,740	1,850	8,220
52	Excess bad debt reserves of financial institutions	10	10	10	....	....	....	....	10
53	Exclusion of interest on life insurance savings	19,200	19,970	20,770	22,600	26,100	28,990	31,350	129,810
54	Special alternative tax on small property and casualty insurance companies	20	20	20	20	20	20	30	110
55	Tax exemption of certain insurance companies owned by tax-exempt organizations	210	220	230	240	250	260	270	1,250
56	Small life insurance company deduction	60	60	60	60	60	60	50	290
57	Exclusion of interest spread of financial institutions	1,450	1,540	1,620	1,710	1,800	1,890	1,990	12,000

Table 19–1. ESTIMATES OF TOTAL INCOME TAX EXPENDITURES—Continued

(in millions of dollars)

		Total from corporations and individuals							
		2005	2006	2007	2008	2009	2010	2011	2007–11
	Housing:								
58	Exclusion of interest on owner-occupied mortgage subsidy bonds	930	990	1,040	1,140	1,210	1,240	1,280	5,910
59	Exclusion of interest on rental housing bonds	410	430	450	500	530	540	550	2,570
60	Deductibility of mortgage interest on owner-occupied homes	62,160	72,060	79,860	87,820	94,490	100,980	108,280	471,430
61	Deductibility of State and local property tax on owner-occupied homes	19,110	15,020	12,810	12,910	12,830	12,720	22,930	74,200
62	Deferral of income from post 1987 installment sales	1,120	1,130	1,160	1,180	1,200	1,310	1,430	6,280
63	Capital gains exclusion on home sales	35,990	39,750	43,900	48,490	59,900	78,860	87,100	318,250
64	Exclusion of net imputed rental income	28,600	29,720	33,210	36,860	40,630	44,785	49,364	204,849
65	Exception from passive loss rules for $25,000 of rental loss	6,470	6,370	6,230	6,060	5,880	5,700	5,510	29,380
66	Credit for low-income housing investments	3,880	4,060	4,250	4,460	4,710	4,950	5,220	23,590
67	Accelerated depreciation on rental housing (normal tax method)	9,610	10,630	11,470	12,660	13,820	14,710	15,920	68,580
	Commerce:								
68	Cancellation of indebtedness	30	160	110	40	40	40	40	270
69	Exceptions from imputed interest rules	50	50	50	50	50	50	50	250
70	Capital gains (except agriculture, timber, iron ore, and coal)	26,170	25,990	26,760	31,280	22,340	17,580	23,410	121,370
71	Capital gains exclusion of small corporation stock	200	230	260	300	320	350	470	1,700
72	Step-up basis of capital gains at death	26,820	29,510	32,460	35,700	36,480	34,560	38,010	177,210
73	Carryover basis of capital gains on gifts	410	540	640	750	790	1,270	6,370	9,820
74	Ordinary income treatment of loss from small business corporation stock sale	50	50	50	50	50	50	50	250
75	Accelerated depreciation of buildings other than rental housing (normal tax method)	–910	–280	90	550	360	950	1,580	3,530
76	Accelerated depreciation of machinery and equipment (normal tax method)	20,220	40,520	52,230	61,940	73,480	81,090	88,460	353,600
77	Expensing of certain small investments (normal tax method)	5,390	4,720	4,360	350	868	1,110	1,460	8,148
78	Graduated corporation income tax rate (normal tax method)	3,160	3,450	3,590	3,940	4,180	4,300	4,390	20,400
79	Exclusion of interest on small issue bonds	390	420	440	480	510	530	540	2,500
80	Deduction for US production activities	6,220	5,150	10,670	12,190	13,110	20,320	22,270	78,560
81	Special rules for certain film and TV production	90	110	90	70	–40	–90	–60	–30
	Transportation:								
82	Deferral of tax on shipping companies	20	20	20	20	20	20	20	100
83	Exclusion of reimbursed employee parking expenses	2,590	2,730	2,880	3,030	3,180	3,330	3,420	15,840
84	Exclusion for employer-provided transit passes	480	550	630	710	790	880	960	3,970
85	Tax credit for certain expenditures for maintaining railroad tracks	70	140	150	110	50	30	10	350
86	Exclusion of interest on bonds for Financing of Highway Projects and rail-truck transfer facilities	....	25	50	75	95	95	100	415
	Community and regional development:								
87	Investment credit for rehabilitation of structures (other than historic)	40	40	40	40	40	40	40	200
88	Exclusion of interest for airport, dock, and similar bonds	800	860	910	990	1,060	1,080	1,120	5,160
89	Exemption of certain mutuals' and cooperatives' income	60	60	70	70	70	70	70	350
90	Empowerment zones and renewal communities	1,120	1,210	1,340	1,480	1,740	1,130	420	6,110
91	New markets tax credit	430	610	830	870	790	670	520	3,680
92	Expensing of environmental remediation costs	70	60	40	....	–20	–10	–10	....
93	Credit to holders of Gulf Tax Credit Bonds	....	....	10	10	10	10	10	50
	Education, training, employment, and social services:								
	Education:								
94	Exclusion of scholarship and fellowship income (normal tax method)	1,380	1,450	1,510	1,580	1,640	1,720	1,790	8,240
95	HOPE tax credit	3,710	3,650	3,060	3,090	3,220	3,240	3,480	16,090
96	Lifetime Learning tax credit	2,330	2,340	2,020	2,030	2,060	2,090	2,220	10,420
97	Education Individual Retirement Accounts	70	90	110	140	180	230	280	940
98	Deductibility of student-loan interest	780	800	810	820	830	840	780	4,080
99	Deduction for higher education expenses	1,830	1,840	....	....	....	....	....	....
100	State prepaid tuition plans	430	540	620	710	810	930	1,090	4,160
101	Exclusion of interest on student-loan bonds	280	300	320	350	370	380	390	1,810
102	Exclusion of interest on bonds for private nonprofit educational facilities	1,080	1,160	1,220	1,330	1,410	1,450	1,500	6,910
103	Credit for holders of zone academy bonds	110	130	140	150	150	150	150	740
104	Exclusion of interest on savings bonds redeemed to finance educational expenses	10	20	20	20	20	20	20	100
105	Parental personal exemption for students age 19 or over	3,760	2,500	1,760	1,650	1,510	1,420	2,740	9,080
106	Deductibility of charitable contributions (education)	3,420	3,680	4,030	4,260	4,550	4,870	5,210	22,920
107	Exclusion of employer-provided educational assistance	560	590	620	660	690	730	40	2,740
108	Special deduction for teacher expenses	160	150	....	....	....	....	....	....
109	Discharge of student loan indebtedness	20	20	20	20	20	20	20	100
	Training, employment, and social services:								
110	Work opportunity tax credit	160	210	190	130	110	70	30	530
111	Welfare-to-work tax credit	70	80	70	40	10	....	....	120
112	Employer provided child care exclusion	610	810	920	960	1,010	1,060	1,070	5,020
113	Employer-provided child care credit	10	10	10	20	20	20	10	80
114	Assistance for adopted foster children	310	320	350	370	400	430	470	2,020
115	Adoption credit and exclusion	360	540	560	570	580	600	540	2,850
116	Exclusion of employee meals and lodging (other than military)	850	890	930	970	1,010	1,060	1,110	5,080

Table 19–1. ESTIMATES OF TOTAL INCOME TAX EXPENDITURES—Continued

(in millions of dollars)

		Total from corporations and individuals							
		2005	2006	2007	2008	2009	2010	2011	2007–11
117	Child credit[2]	41,790	42,090	42,120	42,070	41,830	41,870	31,730	199,620
118	Credit for child and dependent care expenses	3,060	2,740	1,820	1,750	1,660	1,590	1,540	8,360
119	Credit for disabled access expenditures	30	30	30	40	40	40	40	190
120	Deductibility of charitable contributions, other than education and health	29,670	32,550	34,500	36,790	39,410	42,210	45,210	198,120
121	Exclusion of certain foster care payments	440	440	450	450	450	460	470	2,280
122	Exclusion of parsonage allowances	460	480	510	540	580	610	640	2,880
123	Employee retention credit for employers affected by Hurricane Katrina, Rita, and Wilma	....	140	20	20	....	....	....	40
	Health:								
124	Exclusion of employer contributions for medical insurance premiums and medical care	118,420	132,730	146,780	161,120	176,290	191,980	212,820	888,990
125	Self-employed medical insurance premiums	3,790	4,240	4,630	5,080	5,570	6,050	6,730	28,060
126	Medical Savings Accounts / Health Savings Accounts	1,050	1,830	2,650	3,510	3,960	3,910	3,860	17,890
127	Deductibility of medical expenses	6,110	4,410	5,310	6,490	7,720	9,220	12,260	41,000
128	Exclusion of interest on hospital construction bonds	1,880	2,010	2,110	2,300	2,450	2,520	2,600	11,980
129	Deductibility of charitable contributions (health)	3,350	3,670	3,890	4,150	4,450	4,770	5,110	22,370
130	Tax credit for orphan drug research	210	230	260	290	320	360	410	1,640
131	Special Blue Cross/Blue Shield deduction	710	780	850	920	760	830	920	4,280
132	Tax credit for health insurance purchased by certain displaced and retired individuals	20	20	30	30	30	30	30	150
	Income security:								
133	Exclusion of railroad retirement system benefits	390	390	380	360	370	370	350	1,830
134	Exclusion of workers' compensation benefits	5,770	6,000	6,180	6,390	6,630	6,860	7,090	33,150
135	Exclusion of public assistance benefits (normal tax method)	430	450	470	490	510	530	550	2,550
136	Exclusion of special benefits for disabled coal miners	50	50	50	40	40	40	40	210
137	Exclusion of military disability pensions	100	110	110	120	120	130	130	610
	Net exclusion of pension contributions and earnings:								
138	Employer plans	50,630	50,360	52,470	48,100	45,760	44,760	36,910	228,000
139	401(k) plans	37,440	37,330	39,800	43,100	48,810	53,870	47,290	232,870
140	Individual Retirement Accounts	3,100	4,230	5,970	7,180	8,300	8,840	8,060	38,350
141	Low and moderate income savers credit	1,310	1,380	830	....	....	....	....	830
142	Keogh plans	9,400	9,990	10,670	11,630	12,670	13,800	15,040	63,810
	Exclusion of other employee benefits:								
143	Premiums on group term life insurance	2,020	2,070	2,180	2,250	2,310	2,380	2,490	11,610
144	Premiums on accident and disability insurance	280	290	300	310	320	330	340	1,600
145	Income of trusts to finance supplementary unemployment benefits	20	20	20	20	20	20	20	100
146	Special ESOP rules	1,650	1,760	1,890	2,030	2,170	2,330	2,490	10,910
147	Additional deduction for the blind	40	30	30	40	40	40	50	200
148	Additional deduction for the elderly	1,850	1,740	1,740	1,880	1,930	1,980	2,940	10,470
149	Tax credit for the elderly and disabled	20	20	20	10	10	10	10	60
150	Deductibility of casualty losses	250	980	640	300	320	330	360	1,950
151	Earned income tax credit[3]	4,925	5,050	5,150	5,445	5,640	5,810	6,070	28,115
152	Additional exemption for housing Hurricane Katrina displaced individuals	....	110	20	....	....	....	....	20
	Social Security:								
	Exclusion of social security benefits:								
153	Social Security benefits for retired workers	19,110	19,350	19,590	20,250	20,700	21,000	23,330	104,870
154	Social Security benefits for disabled	3,600	3,810	4,110	4,330	4,570	4,960	5,530	23,500
155	Social Security benefits for dependents and survivors	3,940	3,980	4,040	4,070	4,100	4,180	4,360	20,750
	Veterans benefits and services:								
156	Exclusion of veterans death benefits and disability compensation	3,320	3,600	3,770	3,900	4,050	4,140	4,350	20,210
157	Exclusion of veterans pensions	130	140	140	140	140	150	150	720
158	Exclusion of GI bill benefits	150	170	210	240	280	330	400	1,460
159	Exclusion of interest on veterans housing bonds	40	40	50	50	50	50	50	250
	General purpose fiscal assistance:								
160	Exclusion of interest on public purpose State and local bonds	26,360	28,180	29,640	32,330	34,410	35,440	36,510	168,330
161	Deductibility of nonbusiness state and local taxes other than on owner-occupied homes	36,460	30,310	27,210	27,730	28,260	29,000	49,510	161,710
162	Tax credit for corporations receiving income from doing business in U.S. possessions	800	400	40	....	....	....	....	40
	Interest:								
163	Deferral of interest on U.S. savings bonds	1,350	1,340	1,350	1,360	1,380	1,390	1,440	6,920
	Addendum: Aid to State and local governments:								
	Deductibility of:								
	Property taxes on owner-occupied homes	19,110	15,020	12,810	12,910	12,830	12,720	22,930	74,200
	Nonbusiness State and local taxes other than on owner-occupied homes	36,460	30,310	27,210	27,730	28,260	29,000	49,510	161,710
	Exclusion of interest on State and local bonds for:								
	Public purposes	26,360	28,180	29,640	32,330	34,410	35,440	36,510	168,330
	Energy facilities	80	90	90	100	100	110	110	510
	Water, sewage, and hazardous waste disposal facilities	450	480	500	550	580	600	620	2,850

Table 19–1. ESTIMATES OF TOTAL INCOME TAX EXPENDITURES—Continued
(in millions of dollars)

	Total from corporations and individuals							
	2005	2006	2007	2008	2009	2010	2011	2007–11
Small-issues	390	420	440	480	510	530	540	2,500
Owner-occupied mortgage subsidies	930	990	1,040	1,140	1,210	1,240	1,280	5,910
Rental housing	410	430	450	500	530	540	550	2,570
Airports, docks, and similar facilities	800	860	910	990	1,060	1,080	1,120	5,160
Student loans	280	300	320	350	370	380	390	1,810
Private nonprofit educational facilities	1,080	1,160	1,220	1,330	1,410	1,450	1,500	6,910
Hospital construction	1,880	2,010	2,110	2,300	2,450	2,520	2,600	11,980
Veterans' housing	40	40	50	50	50	50	50	250
Credit for holders of zone academy bonds	110	130	140	150	150	150	150	740

[1] In addition, the alcohol fuel credit results in a reduction in excise tax receipts (in millions of dollars) as follows: 2005 $1,500; 2006 $2,110; 2007 $2,400; 2008 $2,740; 2009 $3,080; 2010 $3,410 and 2011 $870.
[2] The figures in the table indicate the effect of the child tax credit on receipts. The effect of the credit on outlays (in millions of dollars) is as follows: 2005 $14,620; 2006 $14,110; 2007 $13,540; 2008 $12,950; 2009 $12,760 and 2010 $12,330:2011 $12,110
[3] The figures in the table indicate the effect of the earned income tax credit on receipts. The effect of the credit on outlays (in millions of dollars) is as follows: 2005 $34,559;2006 $35,098; 2007 $35,645; 2008 $36,955; 2009 $38,048; 2010 $38,823; and 2011 $40,278.
Note: Provisions with estimates denoted normal tax method have no revenue loss under the reference tax law method.
All estimates have been rounded to the nearest $10 million. Provisions with estimates that rounded to zero in each year are not included in the table.

Present-Value Estimates

The annual value of tax expenditures for tax deferrals is reported on a cash basis in all tables except Table 19–4. Cash-based estimates reflect the difference between taxes deferred in the current year and incoming revenues that are received due to deferrals of taxes from prior years. Although such estimates are useful as a measure of cash flows into the Government, they do not accurately reflect the true economic cost of these provisions. For example, for a provision where activity levels have changed, so that incoming tax receipts from past deferrals are greater than deferred receipts from new activity, the cash-basis tax expenditure estimate can be negative, despite the fact that in present-value terms current deferrals have a real cost to the Government. Alternatively, in the case of a newly enacted deferral provision, a cash-based estimate can overstate the real effect on receipts to the Government because the newly deferred taxes will ultimately be received. Present-value estimates, which are a useful complement to the cash-basis estimates for provisions involving deferrals, are discussed below.

Discounted present-value estimates of revenue effects are presented in Table 19–4 for certain provisions that involve tax deferrals or other long-term revenue effects. These estimates complement the cash-based tax expenditure estimates presented in the other tables.

The present-value estimates represent the revenue effects, net of future tax payments that follow from activities undertaken during calendar year 2005 which cause the deferrals or other long-term revenue effects. For instance, a pension contribution in 2005 would cause a deferral of tax payments on wages in 2005 and on pension earnings on this contribution (e.g., interest) in later years. In some future year, however, the 2005 pension contribution and accrued earnings will be paid out and taxes will be due; these receipts are included in the present-value estimate. In general, this conceptual approach is similar to the one used for reporting the budgetary effects of credit programs, where direct loans and guarantees in a given year affect future cash flows.

Table 19–2. ESTIMATES OF TAX EXPENDITURES FOR THE CORPORATE AND INDIVIDUAL INCOME TAXES

(in millions of dollars)

		Corporations								Individuals							
		2005	2006	2007	2008	2009	2010	2011	2007–11	2005	2006	2007	2008	2009	2010	2011	2007–11
	National Defense																
1	Exclusion of benefits and allowances to armed forces personnel	....	....	....	....	....	....	....	....	2,990	3,020	3,050	3,070	3,110	3,140	3,170	15,390
	International affairs:																
2	Exclusion of income earned abroad by U.S. citizens	....	....	....	....	....	....	....	....	2,750	2,810	2,940	3,100	3,270	3,450	3,640	16,400
3	Exclusion of certain allowances for Federal employees abroad	....	....	....	....	....	....	....	....	900	950	1,000	1,050	1,100	1,160	1,230	5,540
4	Extraterritorial income exclusion	5,220	4,370	1,720	110	50	50	40	1,970	....	....	....	....	....	....	....	....
5	Inventory property sales source rules exception	1,560	1,680	1,840	2,040	2,230	2,380	2,540	11,030	....	....	....	....	....	....	....	....
6	Deferral of income from controlled foreign corporations (normal tax method)	10,500	11,160	11,940	12,770	13,650	14,600	15,620	68,580	....	....	....	....	....	....	....	....
7	Deferred taxes for financial firms on certain income earned overseas	2,190	2,260	960	....	....	....	....	960	....	....	....	....	....	....	....	....
	General science, space, and technology:																
8	Expensing of research and experimentation expenditures (normal tax method)	4,010	7,770	6,850	6,140	5,250	4,700	4,740	27,680	100	150	140	120	110	100	100	570
9	Credit for increasing research activities	5,110	2,120	920	390	180	50	....	1,540	50	40	....	....	....	....	....	....
	Energy:																
10	Expensing of exploration and development costs, fuels	340	590	760	720	560	430	330	2,800	50	90	110	110	90	70	50	430
11	Excess of percentage over cost depletion, fuels	530	600	620	600	580	560	560	2,920	60	70	70	60	60	60	60	310
12	Alternative fuel production credit	2,220	2,290	2,360	950	....	....	....	3,310	100	100	100	40	....	....	....	140
13	Exception from passive loss limitation for working interests in oil and gas properties	....	....	....	....	....	....	....	....	40	40	40	40	40	40	40	200
14	Capital gains treatment of royalties on coal	....	....	....	....	....	....	....	....	90	90	90	100	70	60	80	400
15	Exclusion of interest on energy facility bonds	20	20	20	20	20	20	20	100	60	70	70	80	80	90	90	410
16	Enhanced oil recovery credit	270	....	....	....	....	....	20	20	30	....	....	....	....	....	....	....
17	New technology credit	220	470	640	750	800	810	810	3,810	20	40	50	50	50	50	50	250
18	Alcohol fuel credits [1]	30	30	30	40	40	50	20	180	10	10	10	10	10	10	10	50
19	Tax credit and deduction for clean-fuel burning vehicles	50	30	–10	–10	–20	–30	–30	–100	20	60	210	150	160	10	–10	520
20	Exclusion of utility conservation subsidies	....	....	....	....	....	....	....	....	80	80	80	80	80	70	70	380
21	Credit for holding clean renewable energy bonds	....	....	10	30	40	50	50	180	....	....	....	....	....	....	....	....
22	Deferral of gain from dispositions of transmission property to implement FERC restructuring policy	490	620	530	230	–100	–360	–510	–210	....	....	....	....	....	....	....	....
23	Credit for production from advanced nuclear power facilities	....	....	....	....	....	....	....	....	....	....	....	....	....	....	....	....
24	Credit for investment in clean coal facilities	....	50	50	100	150	200	280	780	....	....	....	....	....	....	....	....
25	Temporary 50% expensing for equipment used in the refining of liquid fuels	....	10	30	120	240	260	180	830	....	....	....	....	....	....	....	....
26	Pass through low sulfur diesel expensing to cooperative owners	....	....	....	....	....	....	....	....	40	....	–10	....	–10	....	–10	–30
27	Natural gas distribution pipelines treated as 15–year property	....	20	50	90	120	150	150	560	....	....	....	....	....	....	....	....
28	Amortize all geological and geophysical expenditures over 2 years	....	30	120	140	110	80	50	500	....	10	30	40	30	20	10	130
29	Allowance of deduction for certain energy efficient commercial building property	....	60	150	110	20	–10	–10	260	....	20	40	30	10	....	....	80
30	Credit for construction of new energy efficient homes	....	10	20	10	10	....	....	40	....	....	....	....	....	....	....	....
31	Credit for energy efficiency improvements to existing homes	....	....	....	....	....	....	....	....	....	220	380	150	....	....	....	530
32	Credit for energy efficient appliances	....	120	80	....	....	....	....	80	....	....	....	....	....	....	....	....
33	30% credit for residential purchases/installations of solar and fuel cells	....	....	....	....	....	....	....	....	....	10	10	10	....	....	....	20
34	Credit for business installation of qualified fuel cells and stationary microturbine power plants	....	60	100	40	–10	–10	–10	110	....	20	30	10	....	....	....	40
35	Alternative Fuel and Fuel Mixture tax credit	....	....	....	....	....	....	....	....	150	170	....	....	....	....	....	....
	Natural resources and environment:																
36	Expensing of exploration and development costs, nonfuel minerals	....	....	....	....	....	....	....	....	....	....	....	....	....	....	....	....
37	Excess of percentage over cost depletion, nonfuel minerals	250	260	280	290	290	310	320	1,490	20	20	20	20	20	20	20	100
38	Exclusion of interest on bonds for water, sewage, and hazardous waste facilities	100	100	100	110	110	110	120	550	350	380	400	440	470	490	500	2,300
39	Capital gains treatment of certain timber income	....	....	....	....	....	....	....	....	90	90	90	100	70	60	80	400
40	Expensing of multiperiod timber growing costs	240	250	260	280	290	300	300	1,430	110	120	120	120	120	130	130	620
41	Tax incentives for preservation of historic structures	270	280	290	310	320	340	360	1,620	80	90	90	90	100	100	110	490
42	Expensing of capital costs with respect to complying with EPA sulfur regulations	10	10	10	30	50	30	....	120	....	....	....	....	....	....	....	....

Table 19–2. ESTIMATES OF TAX EXPENDITURES FOR THE CORPORATE AND INDIVIDUAL INCOME TAXES—Continued

(in millions of dollars)

		Corporations								Individuals							
		2005	2006	2007	2008	2009	2010	2011	2007–11	2005	2006	2007	2008	2009	2010	2011	2007–11
43	Exclusion of gain or loss on sale or exchange of certain brownfield sites			10	20	30	50	40	150				10	10	20	20	60
	Agriculture:																
44	Expensing of certain capital outlays	20	20	20	20	20	20	30	110	90	110	110	110	120	120	120	580
45	Expensing of certain multiperiod production costs	10	10	10	10	10	10	20	60	50	60	60	70	70	70	70	340
46	Treatment of loans forgiven for solvent farmers									10	10	10	10	10	10	10	50
47	Capital gains treatment of certain income									880	870	900	1,050	750	590	780	4,070
48	Income averaging for farmers									40	40	40	40	40	40	50	210
49	Deferral of gain on sale of farm refiners	10	10	20	20	20	20	20	100								
50	Bio-Diesel and small agri-biodiesel producer tax credits									30	90	100	90	40	20	20	270
	Commerce and housing:																
	Financial institutions and insurance:																
51	Exemption of credit union income	1290	1370	1450	1540	1640	1,740	1,850	8,220								
52	Excess bad debt reserves of financial institutions	10	10	10					10								
53	Exclusion of interest on life insurance savings	1,760	1,830	1,910	2,120	2,400	2,620	2,810	11,860	17,440	18,140	18,860	20,480	23,700	26,370	28,540	117,950
54	Special alternative tax on small property and casualty insurance companies	20	20	20	20	20	20	30	110								
55	Tax exemption of certain insurance companies owned by tax-exempt organizations	210	220	230	240	250	260	270	1,250								
56	Small life insurance company deduction	60	60	60	60	60	60	50	290								
57	Exclusion of interest spread of financial institutions									1,450	1,540	1,620	1,710	1,800	1,890	1,990	12,000
	Housing:																
58	Exclusion of interest on owner-occupied mortgage subsidy bonds	200	210	210	220	230	230	240	1,130	730	780	830	920	980	1,010	1,040	4,780
59	Exclusion of interest on rental housing bonds	90	90	90	100	100	100	100	490	320	340	360	400	430	440	450	2,080
60	Deductibility of mortgage interest on owner-occupied homes									62,160	72,060	79,860	87,820	94,490	100,980	108,280	471,430
61	Deductibility of State and local property tax on owner-occupied homes									19,110	15,020	12,810	12,910	12,830	12,720	22,930	74,200
62	Deferral of income from post 1987 installment sales	290	290	300	300	310	310	310	1,530	830	840	860	880	890	1,000	1,120	4,750
63	Capital gains exclusion on home sales									35,990	39,750	43,900	48,490	59,900	78,860	87,100	318,250
64	Exclusion of net imputed rental income									28,600	29,720	33,210	36,860	40,630	44,785	49,364	204,849
65	Exception from passive loss rules for $25,000 of rental loss									6470	6370	6230	6060	5880	5700	5510	29,380
66	Credit for low-income housing investments	3,300	3,450	3,610	3,790	4,000	4,210	4,440	20,050	580	610	640	670	710	740	780	3,540
67	Accelerated depreciation on rental housing (normal tax method)	650	710	760	840	910	960	1,030	4,500	8,960	9,920	10,710	11,820	12,910	13,750	14,890	64,080
	Commerce:																
68	Cancellation of indebtedness									30	160	110	40	40	40	40	270
69	Exceptions from imputed interest rules									50	50	50	50	50	50	50	250
70	Capital gains (except agriculture, timber, iron ore, and coal)									26,170	25,990	26,760	31,280	22,340	17,580	23,410	121,370
71	Capital gains exclusion of small corporation stock									200	230	260	300	320	350	470	1,700
72	Step-up basis of capital gains at death									26,820	29,510	32,460	35,700	36,480	34,560	38,010	177,210
73	Carryover basis of capital gains on gifts									410	540	640	750	790	1,270	6,370	9,820
74	Ordinary income treatment of loss from small business corporation stock sale									50	50	50	50	50	50	50	250
75	Accelerated depreciation of buildings other than rental housing (normal tax method)	220	400	530	720	730	970	1,230	4,180	–1,130	–680	–440	–170	–370	–20	350	–650
76	Accelerated depreciation of machinery and equipment (normal tax method)	15,850	30,250	39,870	47,870	57,290	63,410	69,170	277,610	4,370	10,270	12,360	14,070	16,190	17,680	19,290	75,990
77	Expensing of certain small investments (normal tax method)	1,710	1,440	1,240	–280	–2	160	310	1,428	3,680	3,280	3,120	630	870	950	1,150	6,720
78	Graduated corporation income tax rate (normal tax method)	3,160	3,450	3,590	3,940	4,180	4,300	4,390	20,400								
79	Exclusion of interest on small issue bonds	80	90	90	90	100	100	100	480	310	330	350	390	410	430	440	2,020
80	Deduction for US production activities	4,870	3,980	8,320	9,770	10,630	16,550	16,880	62,150	1,350	1,170	2,350	2,420	2,480	3,770	5,390	16,410
81	Special rules for certain film and TV production	70	90	70	60	–30	–70	–50	–20	20	20	20	10	–10	–20	–10	–10
	Transportation:																
82	Deferral of tax on shipping companies	20	20	20	20	20	20	20	100								
83	Exclusion of reimbursed employee parking expenses									2,590	2,730	2,880	3,030	3,180	3,330	3,420	15,840
84	Exclusion for employer-provided transit passes									480	550	630	710	790	880	960	3,970
85	Tax credit for certain expenditures for maintaining railroad tracks	70	140	150	110	50	30	10	350								
86	Exclusion of interest on bonds for Financing of Highway Projects and rail-truck transfer facilities		10	15	20	25	25	25	110		15	35	55	70	70	75	305

Table 19–2. ESTIMATES OF TAX EXPENDITURES FOR THE CORPORATE AND INDIVIDUAL INCOME TAXES—Continued

(in millions of dollars)

		Corporations								Individuals							
		2005	2006	2007	2008	2009	2010	2011	2007–11	2005	2006	2007	2008	2009	2010	2011	2007–11
	Community and regional development:																
87	Investment credit for rehabilitation of structures (other than historic)	20	20	20	20	20	20	20	100	20	20	20	20	20	20	20	100
88	Exclusion of interest for airport, dock, and similar bonds	170	180	190	190	200	200	210	990	630	680	720	800	860	880	910	4,170
89	Exemption of certain mutuals' and cooperatives' income	60	60	70	70	70	70	70	350								
90	Empowerment zones and renewal communities	290	310	340	370	420	190	60	1,380	830	900	1,000	1,110	1,320	940	360	4,730
91	New markets tax credit	110	150	210	220	200	170	130	930	320	460	620	650	590	500	390	2,750
92	Expensing of environmental remediation costs	60	50	30		–20	–10	–10	–10	10	10	10					10
93	Credit to holders of Gulf Tax Credit Bonds											10	10	10	10	10	50
	Education, training, employment, and social services:																
	Education:																
94	Exclusion of scholarship and fellowship income (normal tax method)									1,380	1,450	1,510	1,580	1,640	1,720	1,790	8,240
95	HOPE tax credit									3,710	3,650	3,060	3,090	3,220	3,240	3,480	16,090
96	Lifetime Learning tax credit									2,330	2,340	2,020	2,030	2,060	2,090	2,220	10,420
97	Education Individual Retirement Accounts									70	90	110	140	180	230	280	940
98	Deductibility of student-loan interest									780	800	810	820	830	840	780	4,080
99	Deduction for higher education expenses									1,830	1,840						
100	State prepaid tuition plans									430	540	620	710	810	930	1,090	4,160
101	Exclusion of interest on student-loan bonds	60	60	70	70	70	70	70	350	220	240	250	280	300	310	320	1,460
102	Exclusion of interest on bonds for private nonprofit educational facilities	230	240	250	260	260	270	280	1,320	850	920	970	1070	1150	1180	1220	5,590
103	Credit for holders of zone academy bonds	110	130	140	150	150	150	150	740								
104	Exclusion of interest on savings bonds redeemed to finance educational expenses									10	20	20	20	20	20	20	100
105	Parental personal exemption for students age 19 or over									3,760	2,500	1,760	1,650	1,510	1,420	2,740	9,080
106	Deductibility of charitable contributions (education)	540	560	590	620	660	700	740	3,310	2,880	3,120	3,440	3,640	3,890	4,170	4,470	19,610
107	Exclusion of employer-provided educational assistance									560	590	620	660	690	730	40	2,740
108	Special deduction for teacher expenses									160	150						
109	Discharge of student loan indebtedness									20	20	20	20	20	20	20	100
	Training, employment, and social services:																
110	Work opportunity tax credit	130	180	150	100	80	50	20	400	30	30	40	30	30	20	10	130
111	Welfare-to-work tax credit	60	70	60	30	10			100	10	10	10	10				20
112	Employer provided child care exclusion									610	810	920	960	1010	1060	1070	5,020
113	Employer-provided child care credit									10	10	10	20	20	20	10	80
114	Assistance for adopted foster children									310	320	350	370	400	430	470	2,020
115	Adoption credit and exclusion									360	540	560	570	580	600	540	2,850
116	Exclusion of employee meals and lodging (other than military)									850	890	930	970	1,010	1,060	1,110	5,080
117	Child credit [2]									41,790	42,090	42,120	42,070	41,830	41,870	31,730	199,620
118	Credit for child and dependent care expenses									3,060	2,740	1,820	1,750	1,660	1,590	1,540	8,360
119	Credit for disabled access expenditures	10	10	10	10	10	10	10	50	20	20	20	30	30	30	30	140
120	Deductibility of charitable contributions, other than education and health	1,230	1,290	1,360	1,430	1,500	1,570	1640	7,500	28,440	31,260	33,140	35,360	37,910	40,640	43,570	190,620
121	Exclusion of certain foster care payments									440	440	450	450	450	460	470	2,280
122	Exclusion of parsonage allowances									460	480	510	540	580	610	640	2,880
123	Employee retention credit for employers affected by Hurricane Katrina, Rita, and Wilma		40								100	20	20				40
	Health:																
124	Exclusion of employer contributions for medical insurance premiums and medical care									118,420	132,730	146,780	161,120	176,290	191,980	212,820	888,990
125	Self-employed medical insurance premiums									3,790	4,240	4,630	5,080	5,570	6,050	6,730	28,060
126	Medical Savings Accounts / Health Savings Accounts									1,050	1,830	2,650	3,510	3,960	3,910	3,860	17,890
127	Deductibility of medical expenses									6,110	4,410	5,310	6,490	7,720	9,220	12,260	41,000
128	Exclusion of interest on hospital construction bonds	410	420	430	440	460	470	490	2,290	1,470	1,590	1,680	1,860	1,990	2,050	2,110	9,690
129	Deductibility of charitable contributions (health)	160	160	170	180	190	200	210	950	3,190	3,510	3,720	3,970	4,260	4,570	4,900	21,420
130	Tax credit for orphan drug research	210	230	260	290	320	360	410	1,640								
131	Special Blue Cross/Blue Shield deduction	710	780	850	920	760	830	920	4,280								

Table 19–2. ESTIMATES OF TAX EXPENDITURES FOR THE CORPORATE AND INDIVIDUAL INCOME TAXES—Continued

(in millions of dollars)

		Corporations								Individuals							
		2005	2006	2007	2008	2009	2010	2011	2007–11	2005	2006	2007	2008	2009	2010	2011	2007–11
132	Tax credit for health insurance purchased by certain displaced and retired individuals									20	20	30	30	30	30	30	150
	Income security:																
133	Exclusion of railroad retirement system benefits									390	390	380	360	370	370	350	1,830
134	Exclusion of workers' compensation benefits									5,770	6,000	6,180	6,390	6,630	6,860	7,090	33,150
135	Exclusion of public assistance benefits (normal tax method)									430	450	470	490	510	530	550	2,550
136	Exclusion of special benefits for disabled coal miners									50	50	50	40	40	40	40	210
137	Exclusion of military disability pensions									100	110	110	120	120	130	130	610
	Net exclusion of pension contributions and earnings:																
138	Employer plans									50,630	50,360	52,470	48,100	45,760	44,760	36,910	228,000
139	401(k) plans									37,440	37,330	39,800	43,100	48,810	53,870	47,290	232,870
140	Individual Retirement Accounts									3,100	4,230	5,970	7,180	8,300	8,840	8,060	38,350
141	Low and moderate income savers credit									1,310	1,380	830					830
142	Keogh plans									9,400	9,990	10,670	11,630	12,670	13,800	15,040	63,810
	Exclusion of other employee benefits:																
143	Premiums on group term life insurance									2,020	2,070	2,180	2,250	2,310	2,380	2,490	11,610
144	Premiums on accident and disability insurance									280	290	300	310	320	330	340	1,600
145	Income of trusts to finance supplementary unemployment benefits									20	20	20	20	20	20	20	100
146	Special ESOP rules	1310	1410	1520	1640	1780	1940	2100	8,980	340	350	370	390	390	390	390	1,930
147	Additional deduction for the blind									40	30	30	40	40	40	50	200
148	Additional deduction for the elderly									1,850	1,740	1,740	1,880	1,930	1,980	2,940	10,470
149	Tax credit for the elderly and disabled									20	20	20	10	10	10	10	60
150	Deductibility of casualty losses									250	980	640	300	320	330	360	1,950
151	Earned income tax credit [3]									4,925	5,050	5,150	5,445	5,640	5,810	6,070	28,115
152	Additional exemption for housing Hurricane Katrina displaced individuals										110	20					20
	Social Security:																
	Exclusion of social security benefits:																
153	Social Security benefits for retired workers									19,110	19,350	19,590	20,250	20,700	21,000	23,330	104,870
154	Social Security benefits for disabled									3,600	3,810	4,110	4,330	4,570	4,960	5,530	23,500
155	Social Security benefits for dependents and survivors									3,940	3,980	4,040	4,070	4,100	4,180	4,360	20,750
	Veterans benefits and services:																
156	Exclusion of veterans death benefits and disability compensation									3,320	3,600	3,770	3,900	4,050	4,140	4,350	20,210
157	Exclusion of veterans pensions									130	140	140	140	140	150	150	720
158	Exclusion of GI bill benefits									150	170	210	240	280	330	400	1,460
159	Exclusion of interest on veterans housing bonds	10	10	10	10	10	10	10	50	30	30	40	40	40	40	40	200
	General purpose fiscal assistance:																
160	Exclusion of interest on public purpose State and local bonds	5,710	5,880	6,060	6,240	6,430	6,620	6,820	32,170	20,650	22,300	23,580	26,090	27,980	28,820	29,690	136,160
161	Deductibility of nonbusiness state and local taxes other than on owner-occupied homes									36,460	30,310	27,210	27,730	28,260	29,000	49,510	161,710
162	Tax credit for corporations receiving income from doing business in U.S. possessions	800	400	40					40								
	Interest:																
163	Deferral of interest on U.S. savings bonds									1,350	1,340	1,350	1,360	1,380	1,390	1,440	6,920
	Addendum: Aid to State and local governments:																
	Deductibility of:																
	Property taxes on owner-occupied homes									19,110	15,020	12,810	12,910	12,830	12,720	22,930	74,200
	Nonbusiness State and local taxes other than on owner-occupied homes									36,460	30,310	27,210	27,730	28,260	29,000	49,510	161,710
	Exclusion of interest on State and local bonds for:																
	Public purposes	5,710	5,880	6,060	6,240	6,430	6,620	6,820	32,170	20,650	22,300	23,580	26,090	27,980	28,820	29,690	136,160
	Energy facilities	20	20	20	20	20	20	20	100	60	70	70	80	80	90	90	410
	Water, sewage, and hazardous waste disposal facilities	100	100	100	110	110	110	120	550	350	380	400	440	470	490	500	2,300
	Small-issues	80	90	90	90	100	100	100	480	310	330	350	390	410	430	440	2,020
	Owner-occupied mortgage subsidies	200	210	210	220	230	230	240	1,130	730	780	830	920	980	1,010	1,040	4,780
	Rental housing	90	90	90	100	100	100	100	490	320	340	360	400	430	440	450	2,080
	Airports, docks, and similar facilities	170	180	190	190	200	200	210	990	630	680	720	800	860	880	910	4,170
	Student loans	60	60	70	70	70	70	70	350	220	240	250	280	300	310	320	1,460
	Private nonprofit educational facilities	230	240	250	260	260	270	280	1,320	850	920	970	1,070	1,150	1,180	1,220	5,590
	Hospital construction	410	420	430	440	460	470	490	2,290	1,470	1,590	1,680	1,860	1,990	2,050	2,110	9,690
	Veterans' housing	10	10	10	10	10	10	10	50	30	30	40	40	40	40	40	200

Table 19–2. ESTIMATES OF TAX EXPENDITURES FOR THE CORPORATE AND INDIVIDUAL INCOME TAXES—Continued

(in millions of dollars)

		Corporations								Individuals							
		2005	2006	2007	2008	2009	2010	2011	2007–11	2005	2006	2007	2008	2009	2010	2011	2007–11
	Credit for holders of zone academy bonds ..	110	130	140	150	150	150	150	740	....	....	....	....	....	....	....	....

[1] In addition, the alcohol fuel credit results in a reduction in excise tax receipts (in millions of dollars) as follows: 2005 $1,500; 2006 $2,110; 2007 $2,400; 2008 $2,740; 2009 $3,080; 2010 $3,410 and 2011 $870.

[2] The figures in the table indicate the effect of the child tax credit on receipts. The effect of the credit on outlays (in millions of dollars) is as follows: 2005 $14,620; 2006 $14,110; 2007 $13,540; 2008 $12,950; 2009 $12,760 and 2010 $12,330:2011 $12,110.

[3] The figures in the table indicate the effect of the earned income tax credit on receipts. The effect of the credit on outlays (in millions of dollars) is as follows: 2005 $34,559;2006 $35,098; 2007 $35,645; 2008 $36,955; 2009 $38,048; 2010 $38,823; and 2011 $40,278.

Note: Provisions with estimates denoted normal tax method have no revenue loss under the reference tax law method.

All estimates have been rounded to the nearest $10 million. Provisions with estimates that rounded to zero in each year are not included in the table.

Tax Expenditure Baselines

A tax expenditure is an exception to baseline provisions of the tax structure that usually results in a reduction in the amount of tax owed. The 1974 Congressional Budget Act, which mandated the tax expenditure budget, did not specify the baseline provisions of the tax law. As noted previously, deciding whether provisions are exceptions, therefore, is a matter of judgment. As in prior years, most of this year's tax expenditure estimates are presented using two baselines: the normal tax baseline and the reference tax law baseline. An exception is provided for the lower tax rate on dividends and capital gains on corporate shares as discussed below.

The normal tax baseline is patterned on a comprehensive income tax, which defines income as the sum of consumption and the change in net wealth in a given period of time. The normal tax baseline allows personal exemptions, a standard deduction, and deduction of expenses incurred in earning income. It is not limited to a particular structure of tax rates, or by a specific definition of the taxpaying unit.

In the case of income taxes, the reference tax law baseline is also patterned on a comprehensive income tax, but it is closer to existing law. Tax expenditures under the reference law baseline are generally tax expenditures under the normal tax baseline, but the reverse is not always true.

Both the normal and reference tax baselines allow several major departures from a pure comprehensive income tax. For example, under the normal and reference tax baselines:

- Income is taxable only when it is realized in exchange. Thus, either the deferral of tax on unrealized capital gains nor the tax exclusion of imputed income (such as the rental value of owner-occupied housing or farmers' consumption of their own produce) is regarded as a tax expenditure. Both accrued and imputed income would be taxed under a comprehensive income tax.
- A comprehensive income tax would generally not exclude from the tax base amounts for personal exemptions or a standard deduction, except perhaps to ease tax administration.
- There generally is a separate corporate income tax.
- Tax rates vary by level of income.
- Tax rates are allowed to vary with marital status.
- Values of assets and debt are not generally adjusted for inflation. A comprehensive income tax would adjust the cost basis of capital assets and debt for changes in the price level during the time the assets or debt are held. Thus, under a comprehensive income tax baseline, the failure to take account of inflation in measuring depreciation, capital gains, and interest income would be regarded as a negative tax expenditure (i.e., a tax penalty), and failure to take account of inflation in measuring interest costs would be regarded as a positive tax expenditure (i.e., a tax subsidy).

Although the reference law and normal tax baselines are generally similar, areas of difference include:

Tax rates. The separate schedules applying to the various taxpaying units are included in the reference law baseline. Thus, corporate tax rates below the maximum statutory rate do not give rise to a tax expenditure. The normal tax baseline is similar, except that, by convention, it specifies the current maximum rate as the baseline for the corporate income tax. The lower tax rates applied to the first $10 million of corporate income are thus regarded as a tax expenditure. Again, by convention, the alternative minimum tax is treated as part of the baseline rate structure under both the reference and normal tax methods.

Income subject to the tax. Income subject to tax is defined as gross income less the costs of earning that income. The Federal income tax defines gross income to include: (1) consideration received in the exchange of goods and services, including labor services or property; and (2) the taxpayer's share of gross or net income earned and/or reported by another entity (such as a partnership). Under the reference tax rules, therefore, gross income does not include gifts defined as receipts of money or property that are not consideration in an exchange or most transfer payments, which can be thought of as gifts from the Government.[2] The normal tax baseline also excludes gifts between individuals from gross income. Under the normal tax baseline, however, all cash transfer payments from the Gov-

[2] Gross income does, however, include transfer payments associated with past employment, such as Social Security benefits.

ernment to private individuals are counted in gross income, and exemptions of such transfers from tax are identified as tax expenditures. The costs of earning income are generally deductible in determining taxable income under both the reference and normal tax baselines.[3]

Capital recovery. Under the reference tax law baseline no tax expenditures arise from accelerated depreciation. Under the normal tax baseline, the depreciation allowance for property is computed using estimates of economic depreciation. The latter represents a change in the calculation of the tax expenditure under normal law first made in the 2004 Budget. The Appendix provides further details on the new methodology and how it differs from the prior methodology.

Treatment of foreign income. Both the normal and reference tax baselines allow a tax credit for foreign income taxes paid (up to the amount of U.S. income taxes that would otherwise be due), which prevents double taxation of income earned abroad. Under the normal tax method, however, controlled foreign corporations (CFCs) are not regarded as entities separate from their controlling U.S. shareholders. Thus, the deferral of tax on income received by CFCs is regarded as a tax expenditure under this method. In contrast, except for tax haven activities, the reference law baseline follows current law in treating CFCs as separate taxable entities whose income is not subject to U.S. tax until distributed to U.S. taxpayers. Under this baseline, deferral of tax on CFC income is not a tax expenditure because U.S. taxpayers generally are not taxed on accrued, but unrealized, income.

In addition to these areas of difference, the Joint Committee on Taxation considers a somewhat broader set of tax expenditures under its normal tax baseline than is considered here.

Table 19–3. INCOME TAX EXPENDITURES RANKED BY TOTAL 2007–2011 PROJECTED REVENUE EFFECT

(in millions of dollars)

Provision	2007	2007–11
Exclusion of employer contributions for medical insurance premiums and medical care	146,780	888,990
Deductibility of mortgage interest on owner-occupied homes	79,860	471,430
Accelerated depreciation of machinery and equipment (normal tax method)	52,230	357,200
Capital gains exclusion on home sales	43,900	318,250
401(k) plans	39,800	232,870
Employer plans	52,470	228,000
Exclusion of net imputed rental income	33,210	204,849
Child credit	42,120	199,620
Deductibility of charitable contributions, other than education and health	34,430	198,120
Step-up basis of capital gains at death	32,460	177,210
Exclusion of interest on public purpose State and local bonds	29,640	168,330
Deductibility of nonbusiness state and local taxes other than on owner-occupied homes	27,210	161,710
Exclusion of interest on life insurance savings	20,770	129,810
Capital gains (except agriculture, timber, iron ore, and coal)	26,760	121,370
Social Security benefits for retired workers	19,590	104,870
Deduction for US production activities	10,670	78,560
Deductibility of State and local property tax on owner-occupied homes	12,810	74,200
Deferral of income from controlled foreign corporations (normal tax method)	11,940	68,580
Keogh plans	10,670	63,810
Deductibility of medical expenses	5,310	41,000
Individual Retirement Accounts	5,970	38,350
Exclusion of workers' compensation benefits	6,180	33,150
Exception from passive loss rules for $25,000 of rental loss	6,230	29,380
Expensing of research and experimentation expenditures (normal tax method)	6,990	28,250
Earned income tax credit	5,147	28,104
Self-employed medical insurance premiums	4,630	28,060
Credit for low-income housing investments	4,250	23,590
Social Security benefits for disabled	4,110	23,500
Deductibility of charitable contributions (education)	4,030	22,920
Deductibility of charitable contributions (health)	3,890	22,370
Social Security benefits for dependents and survivors	4,040	20,750
Graduated corporation income tax rate (normal tax method)	3,590	20,400
Exclusion of veterans death benefits and disability compensation	3,770	20,210
Medical Savings Accounts/Health Savings Accounts	2,650	17,890
Exclusion of income earned abroad by U.S. citizens	2,940	16,400
HOPE tax credit	3,060	16,090
Exclusion of reimbursed employee parking expenses	2,880	15,840

[3] In the case of individuals who hold "passive" equity interests in businesses, however, the pro-rata shares of sales and expense deductions reportable in a year are limited. A passive business activity is defined to be one in which the holder of the interest, usually a partnership interest, does not actively perform managerial or other participatory functions. The taxpayer may generally report no larger deductions for a year than will reduce taxable income from such activities to zero. Deductions in excess of the limitation may be taken in subsequent years, or when the interest is liquidated. In addition, costs of earning income may be limited under the alternative minimum tax.

Table 19–3. INCOME TAX EXPENDITURES RANKED BY TOTAL 2007–2011 PROJECTED REVENUE EFFECT—Continued

(in millions of dollars)

Provision	2007	2007–11
Exclusion of benefits and allowances to armed forces personnel	3,050	15,390
Exclusion of interest spread of financial institutions	1,620	12,000
Exclusion of interest on hospital construction bonds	2,110	11,980
Premiums on group term life insurance	2,180	11,610
Inventory property sales source rules exception	1,840	11,030
Special ESOP rules	1,890	10,910
Additional deduction for the elderly	1,740	10,470
Lifetime Learning tax credit	2,020	10,420
Carryover basis of capital gains on gifts	640	9,820
Parental personal exemption for students age 19 or over	1,760	9,080
Credit for child and dependent care expenses	1,820	8,360
Exclusion of scholarship and fellowship income (normal tax method)	1,510	8,240
Exemption of credit union income	1,450	8,220
Expensing of certain small investments (normal tax method)	4,360	8,148
Deferral of interest on U.S. savings bonds	1,350	6,920
Exclusion of interest on bonds for private nonprofit educational facilities	1,220	6,910
Deferral of income from post 1987 installment sales	1,160	6,280
Empowerment zones, Enterprise communities, and Renewal communities	1,340	6,110
Exclusion of interest on owner-occupied mortgage subsidy bonds	1,040	5,910
Exclusion of certain allowances for Federal employees abroad	1,000	5,540
Exclusion of interest for airport, dock, and similar bonds	910	5,160
Exclusion of employee meals and lodging (other than military)	930	5,080
Employer provided child care exclusion	920	5,020
Special Blue Cross/Blue Shield deduction	850	4,280
State prepaid tuition plans	620	4,160
Deductibility of student-loan interest	810	4,080
Capital gains treatment of certain income	900	4,070
New technology credit	690	4,060
Exclusion for employer-provided transit passes	630	3,970
New markets tax credit	830	3,680
Accelerated depreciation of buildings other than rental housing (normal tax method)	90	3,530
Alternative fuel production credit	2,460	3,450
Excess of percentage over cost depletion, fuels	690	3,230
Expensing of exploration and development costs, fuels	870	3,230
Exclusion of parsonage allowances	510	2,880
Exclusion of interest on bonds for water, sewage, and hazardous waste facilities	500	2,850
Adoption credit and exclusion	560	2,850
Exclusion of employer-provided educational assistance	620	2,740
Exclusion of interest on rental housing bonds	450	2,570
Exclusion of public assistance benefits (normal tax method)	470	2,550
Exclusion of interest on small issue bonds	440	2,500
Extraterritorial income exclusion	1,960	2,350
Exclusion of certain foster care payments	450	2,280
Tax incentives for preservation of historic structures	380	2,110
Expensing of multiperiod timber growing costs	380	2,050
Assistance for adopted foster children	350	2,020
Deductibility of casualty losses	640	1,950
Exclusion of railroad retirement system benefits	380	1,830
Exclusion of interest on student-loan bonds	320	1,810
Capital gains exclusion of small corporation stock	260	1,700
Tax credit for orphan drug research	260	1,640
Premiums on accident and disability insurance	300	1,600
Excess of percentage over cost depletion, nonfuel minerals	300	1,590
Credit for increasing research activities	920	1,540
Exclusion of GI bill benefits	210	1,460
Tax exemption of certain insurance companies owned by tax-exempt organizations	230	1,250
Deferred taxes for financial firms on certain income earned overseas	960	960
Education Individual Retirement Accounts	110	940
Low and moderate income savers credit	830	830
Temporary 50% expensing for equipment used in the refining of liquid fuels	30	830
Credit for investment in clean coal facilities	50	780
Credit for holders of zone academy bonds	140	740
Exclusion of veterans pensions	140	720
Expensing of certain capital outlays	130	690
Amortize all geological and geophysical expenditures over 2 years	150	630
Exclusion of military disability pensions	110	610
Natural gas distribution pipelines treated as 15–year property	50	560

Table 19–3. INCOME TAX EXPENDITURES RANKED BY TOTAL 2007–2011 PROJECTED REVENUE EFFECT—Continued

(in millions of dollars)

Provision	2007	2007–11
Work opportunity tax credit	190	530
Credit for energy efficiency improvements to existing homes	380	530
Exclusion of interest on energy facility bonds	90	510
Tax credit and deduction for clean-fuel burning vehicles	200	420
Exclusion of interest on bonds for Financing of Highway Projects and rail-truck transfer facilities	50	415
Capital gains treatment of royalties on coal	90	400
Capital gains treatment of certain timber income	90	400
Expensing of certain multiperiod production costs	70	400
Exclusion of utility conservation subsidies	80	380
Tax credit for certain expenditures for maintaining railroad tracks	150	350
Exemption of certain mutuals' and cooperatives' income	70	350
Allowance of deduction for certain energy efficient commercial building property	190	340
Small life insurance company deduction	60	290
Cancellation of indebtedness	110	270
Bio-Diesel tax credit	100	270
Exclusion of interest on veterans housing bonds	50	250
Exceptions from imputed interest rules	50	250
Ordinary income treatment of loss from small business corporation stock sale	50	250
Alcohol fuel credits	40	230
Exclusion of special benefits for disabled coal miners	50	210
Income averaging for farmers	40	210
Exclusion of gain or loss on sale or exchange of certain brownfield sites	10	210
Investment credit for rehabilitation of structures (other than historic)	40	200
Additional deduction for the blind	30	200
Exception from passive loss limitation for working interests in oil and gas properties	40	200
Credit for disabled access expenditures	30	190
Credit for holding clean renewable energy bonds	10	180
Tax credit for health insurance purchased by certain displaced and retired individuals	30	150
Credit for business installation of qualified fuel cells and stationary microturbine power plants	130	150
Welfare-to-work tax credit	70	120
Expensing of capital costs with respect to complying with EPA sulfur regulations	11	113
Special alternative tax on small property and casualty insurance companies	20	110
Deferral of tax on shipping companies	20	100
Exclusion of interest on savings bonds redeemed to finance educational expenses	20	100
Discharge of student loan indebtedness	20	100
Income of trusts to finance supplementary unemployment benefits	20	100
Deferral of gain on sale of farm refiners	20	100
Employer-provided child care credit	10	80
Credit for energy efficient appliances	80	80
Tax credit for the elderly and disabled	20	60
Treatment of loans forgiven for solvent farmers	10	50
Credit to holders of Gulf Tax Credit Bonds	10	50
Tax credit for corporations receiving income from doing business in U.S. possessions	40	40
Credit for construction of new energy efficient homes	20	40
Employee retention credit for employers affected by Hurricane Katrina, Rita, and Wilma	20	40
Enhanced oil recovery credit	....	20
30% credit for residential purchases/installations of solar and fuel cells	10	20
Additional exemption for housing Hurricane Katrina displaced individuals	20	20
Excess bad debt reserves of financial institutions	10	10
Deduction for higher education expenses	....	....
Expensing of exploration and development costs, nonfuel minerals	....	....
Special deduction for teacher expenses	....	....
Expensing of environmental remediation costs	40	....
Alternative Fuel and Fuel Mixture tax credit	....	....
Credit for production from advanced nuclear power facilities	....	....
Special rules for certain film and TV production	90	–30
Pass through low sulfur diesel expensing to cooperative owners	–10	–30
Deferral of gain from dispositions of transmission property to implement FERC restructuring policy	530	–210

Table 19–4. PRESENT VALUE OF SELECTED TAX EXPENDITURES FOR ACTIVITY IN CALENDAR YEAR 2005
(in millions of dollars)

	Provision	2005 Present Value of Revenue Loss
1	Deferral of income from controlled foreign corporations (normal tax method)	10,020
2	Deferred taxes for financial firms on income earned overseas	2,270
3	Expensing of research and experimentation expenditures (normal tax method)	2,390
4	Expensing of exploration and development costs—fuels	180
5	Expensing of exploration and development costs—nonfuels	10
6	Expensing of multiperiod timber growing costs	200
7	Expensing of certain multiperiod production costs—agriculture	140
8	Expensing of certain capital outlays—agriculture	180
9	Deferral of income on life insurance and annuity contracts	19,640
10	Accelerated depreciation on rental housing	16,088
11	Accelerated depreciation of buildings other than rental	15,980
12	Accelerated depreciation of machinery and equipment	64,330
13	Expensing of certain small investments (normal tax method)	1,100
14	Deferral of tax on shipping companies	20
15	Credit for holders of zone academy bonds	210
16	Credit for low-income housing investments	3,970
17	Deferral for state prepaid tuition plans	1,190
18	Exclusion of pension contributions—employer plans	81,160
19	Exclusion of 401(k) contributions	102,640
20	Exclusion of IRA contributions and earnings	4,460
21	Exclusion of contributions and earnings for Keogh plans	3,190
22	Exclusion of interest on public-purpose bonds	19,830
23	Exclusion of interest on non-public purpose bonds	6,700
24	Deferral of interest on U.S. savings bonds	410
25	Exclusion of Roth earnings and distributions	8,170
26	Exclusion of non-deductible IRA earnings	370

Double Taxation of Corporate Profits

In a gradual transition to a more economically neutral tax system where corporate income is subject to a single layer of tax, the lower tax rates on dividends and capital gains on corporate equity have not been considered tax preferences since the 2005 Budget. Thus, the difference between ordinary tax rates and the lower tax rates on dividends, introduced by the Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA), does not give rise to a tax expenditure. Similarly, the lower capital gains tax rates applied to gains realized from the disposition of corporate equity do not give rise to a tax expenditure. As a consequence, tax expenditure estimates for the lower tax rates on capital, step-up in basis, and the inside build-up on pension assets, 401k plans, IRAs, among others, are limited to capital gains from sources other than corporate equity. The Appendix provides a greater discussion of alternative baselines.

Performance Measures and the Economic Effects of Tax Expenditures

The Government Performance and Results Act of 1993 (GPRA) directs Federal agencies to develop annual and strategic plans for their programs and activities. These plans set out performance objectives to be achieved over a specific time period. Most of these objectives will be achieved through direct expenditure programs. Tax expenditures, however, may also contribute to achieving these goals. The report of the Senate Governmental Affairs Committee on GPRA[4] calls on the Executive Branch to undertake a series of analyses to assess the effect of specific tax expenditures on the achievement of agencies' performance objectives.

The Executive Branch is continuing to focus on the availability of data needed to assess the effects of the tax expenditures designed to increase savings. Treasury's Office of Tax Analysis and Statistics of Income Division (IRS) have developed a new sample of individual income tax filers as one part of this effort. This new "panel" sample will follow the same taxpayers over a period of at least ten years. The first year of this panel sample was drawn from tax returns filed in 2000 for tax year 1999. The sample will capture the changing demographic and economic circumstances of individuals and the effects of changes in tax law over an extended period of time. Data from the sample will therefore permit more extensive, and better, analyses of many tax provisions than can be performed using only annual ("cross-section") data. In particular, data from this panel sample will enhance our ability to analyze the effect of tax expenditures designed to increase savings. Other efforts by OMB, Treasury, and other agencies to improve data available for the analysis of savings tax expenditures will continue over the next several years.

[4] Committee on Government Affairs, United States Senate, "Government Performance and Results Act of 1993" (Report 103–58, 1993).

Comparison of tax expenditure, spending, and regulatory policies. Tax expenditures by definition work through the tax system and, particularly, the income tax. Thus, they may be relatively advantageous policy approaches when the benefit or incentive is related to income and is intended to be widely available.[5] Because there is an existing public administrative and private compliance structure for the tax system, the incremental administrative and compliance costs for a tax expenditure may be low in many cases. In addition, some tax expenditures actually simplify the operation of the tax system, (for example, the exclusion for up to $500,000 of capital gains on home sales). Tax expenditures also implicitly subsidize certain activities. Spending, regulatory or tax-disincentive policies can also modify behavior, but may have different economic effects. Finally, a variety of tax expenditure tools can be used e.g., deductions, credits, exemptions, deferrals, floors, ceilings; phase-ins; phase-outs; dependent on income, expenses, or demographic characteristics (age, number of family members, etc.). This wide range of policy instruments means that tax expenditures can be flexible and can have very different economic effects.

Tax expenditures also have limitations. In many cases they add to the complexity of the tax system, which raises both administrative and compliance costs. For example, personal exemptions, deductions, credits and phase-outs can complicate filing and decision-making. The income tax system may have little or no contact with persons who have no or very low incomes, and does not require information on certain characteristics of individuals used in some spending programs, such as wealth. These features may reduce the effectiveness of tax expenditures for addressing certain income-transfer objectives. Tax expenditures also generally do not enable the same degree of agency discretion as an outlay program. For example, grant or direct Federal service delivery programs can prioritize activities to be addressed with specific resources in a way that is difficult to emulate with tax expenditures.

Outlay programs have advantages where direct Government service provision is particularly warranted such as equipping and providing the armed forces or administering the system of justice. Outlay programs may also be specifically designed to meet the needs of low-income families who would not otherwise be subject to income taxes or need to file a tax return. Outlay programs may also receive more year-to-year oversight and fine tuning through the legislative and executive budget process. In addition, many different types of spending programs including direct Government provision; credit programs; and payments to State and local governments, the private sector, or individuals in the form of grants or contracts provide flexibility for policy design. On the other hand, certain outlay programs such as direct Government service provision may rely less directly on economic incentives and private-market provision than tax incentives, which may reduce the relative efficiency of spending programs for some goals. Spending programs also require resources to be raised via taxes, user charges, or Government borrowing, which can impose further costs by diverting resources from their most efficient uses. Finally, spending programs, particularly on the discretionary side, may respond less readily to changing activity levels and economic conditions than tax expenditures.

Regulations have more direct and immediate effects than outlay and tax-expenditure programs because regulations apply directly and immediately to the regulated party (i.e., the intended actor) generally in the private sector. Regulations can also be fine-tuned more quickly than tax expenditures because they can often be changed as needed by the Executive Branch without legislation. Like tax expenditures, regulations often rely largely on voluntary compliance, rather than detailed inspections and policing. As such, the public administrative costs tend to be modest relative to the private resource costs associated with modifying activities. Historically, regulations have tended to rely on proscriptive measures, as opposed to economic incentives. This reliance can diminish their economic efficiency, although this feature can also promote full compliance where (as in certain safety-related cases) policymakers believe that trade-offs with economic considerations are not of paramount importance. Also, regulations generally do not directly affect Federal outlays or receipts. Thus, like tax expenditures, they may escape the degree of scrutiny that outlay programs receive. However, major regulations are subjected to a formal regulatory analysis that goes well beyond the analysis required for outlays and tax-expenditures. To some extent, the GPRA requirement for performance evaluation will address this lack of formal analysis.

Some policy objectives are achieved using multiple approaches. For example, minimum wage legislation, the earned income tax credit, and the food stamp program are regulatory, tax expenditure, and direct outlay programs, respectively, all having the objective of improving the economic welfare of low-wage workers.

Tax expenditures, like spending and regulatory programs, have a variety of objectives and effects. When measured against a comprehensive income tax, for example, these include: encouraging certain types of activities (e.g., saving for retirement or investing in certain sectors); increasing certain types of after-tax income (e.g., favorable tax treatment of Social Security income); reducing private compliance costs and Government administrative costs (e.g., the exclusion for up to $500,000 of capital gains on home sales); and promoting tax neutrality (e.g., accelerated depreciation in the presence of inflation). Some of these objectives are well suited to quantitative measurement, while others are less well suited. Also, many tax expenditures, including those cited above, may have more than one objective. For example, accelerated depreciation may encourage investment. In addition, the economic effects of particular provisions can extend beyond their in-

[5] Although this chapter focuses upon tax expenditures under the income tax, tax expenditures also arise under the unified transfer, payroll, and excise tax systems. Such provisions can be useful when they relate to the base of those taxes, such as an excise tax exemption for certain types of consumption deemed meritorious.

tended objectives (e.g., a provision intended to promote an activity or raise certain incomes may have positive or negative effects on tax neutrality).

Performance measurement is generally concerned with inputs, outputs, and outcomes. In the case of tax expenditures, the principal input is usually the revenue effect. Outputs are quantitative or qualitative measures of goods and services, or changes in income and investment, directly produced by these inputs. Outcomes, in turn, represent the changes in the economy, society, or environment that are the ultimate goals of programs.

Thus, for a provision that reduces taxes on certain investment activity, an increase in the amount of investment would likely be a key output. The resulting production from that investment, and, in turn, the associated improvements in national income, welfare, or security, could be the outcomes of interest. For other provisions, such as those designed to address a potential inequity or unintended consequence in the tax code, an important performance measure might be how they change effective tax rates (the discounted present-value of taxes owed on new investments or incremental earnings) or excess burden (an economic measure of the distortions caused by taxes). Effects on the incomes of members of particular groups may be an important measure for certain provisions.

An overview of evaluation issues by budget function. The discussion below considers the types of measures that might be useful for some major programmatic groups of tax expenditures. The discussion is intended to be illustrative and not all encompassing. However, it is premised on the assumption that the data needed to perform the analysis are available or can be developed. In practice, data availability is likely to be a major challenge, and data constraints may limit the assessment of the effectiveness of many provisions. In addition, such assessments can raise significant challenges in economic modeling.

National defense. Some tax expenditures are intended to assist governmental activities. For example, tax preferences for military benefits reflect, among other things, the view that benefits such as housing, subsistence, and moving expenses are intrinsic aspects of military service, and are provided, in part, for the benefit of the employer, the U.S. Government. Tax benefits for combat service are intended to reduce tax burdens on military personnel undertaking hazardous service for the Nation. A portion of the tax expenditure associated with foreign earnings is targeted to benefit U.S. Government civilian personnel working abroad by offsetting the living costs that can be higher than those in the United States. These tax expenditures should be considered together with direct agency budget costs in making programmatic decisions.

International affairs. Tax expenditures are also aimed at goals such as tax neutrality. These include the exclusion for income earned abroad by nongovernmental employees and exclusions for income of U.S.-controlled foreign corporations. Measuring the effectiveness of these provisions raises challenging issues.

General science, space and technology; energy; natural resources and the environment; agriculture; and commerce and housing. A series of tax expenditures reduces the cost of investment, both in specific activities such as research and experimentation, extractive industries, and certain financial activities and more generally, through accelerated depreciation for plant and equipment. These provisions can be evaluated along a number of dimensions. For example, it could be useful to consider the strength of the incentives by measuring their effects on the cost of capital (the interest rate which investments must yield to cover their costs) and effective tax rates. The impact of these provisions on the amounts of corresponding forms of investment (e.g., research spending, exploration activity, equipment) might also be estimated. In some cases, such as research, there is evidence that the investment can provide significant positive externalities that is, economic benefits that are not reflected in the market transactions between private parties. It could be useful to quantify these externalities and compare them with the size of tax expenditures. Measures could also indicate the effects on production from these investments such as numbers or values of patents, energy production and reserves, and industrial production. Issues to be considered include the extent to which the preferences increase production (as opposed to benefiting existing output) and their cost-effectiveness relative to other policies. Analysis could also consider objectives that are more difficult to measure but still are ultimate goals, such as promoting the Nation's technological base, energy security, environmental quality, or economic growth. Such an assessment is likely to involve tax analysis as well as consideration of non-tax matters such as market structure, scientific, and other information (such as the effects of increased domestic fuel production on imports from various regions, or the effects of various energy sources on the environment).

Housing investment also benefits from tax expenditures. The imputed net rental income from owner-occupied housing is excluded from the tax base. The mortgage interest deduction and property tax deduction on personal residences also are reported as tax expenditures because the value of owner-occupied housing services is not included in a taxpayer's taxable income. Taxpayers also may exclude up to $500,000 of the capital gains from the sale of personal residences. Measures of the effectiveness of these provisions could include their effects on increasing the extent of home ownership and the quality of housing. Similarly, analysis of the extent of accumulated inflationary gains is likely to be relevant to evaluation of the capital gains for home sales. Deductibility of State and local property taxes assists with making housing more affordable as well as easing the cost of providing community services through these taxes. Provisions intended to promote investment in rental housing could be evaluated for their effects on making such housing more available and affordable. These provisions should then be compared with alternative programs that address housing supply and demand.

Transportation. Employer-provided parking is a fringe benefit that, for the most part, is excluded from taxation. The tax expenditure estimates reflect the cost of parking that is leased by employers for employees; an estimate is not currently available for the value of parking owned by employers and provided to their employees. The exclusion for employer-provided transit passes is intended to promote use of this mode of transportation, which has environmental and congestion benefits. The tax treatments of these different benefits could be compared with alternative transportation policies.

Community and regional development. A series of tax expenditures is intended to promote community and regional development by reducing the costs of financing specialized infrastructure, such as airports, docks, and stadiums. Empowerment zone and enterprise community provisions are designed to promote activity in disadvantaged areas. These provisions can be compared with grants and other policies designed to spur economic development.

Education, training, employment, and social services. Major provisions in this function are intended to promote post-secondary education, to offset costs of raising children, and to promote a variety of charitable activities. The education incentives can be compared with loans, grants, and other programs designed to promote higher education and training. The child credits are intended to adjust the tax system for the costs of raising children; as such, they could be compared to other Federal tax and spending policies, including related features of the tax system, such as personal exemptions (which are not defined as a tax expenditure). Evaluation of charitable activities requires consideration of the beneficiaries of these activities, who are generally not the parties receiving the tax reduction.

Health. Individuals also benefit from favorable treatment of employer-provided health insurance. Measures of these benefits could include increased coverage and pooling of risks. The effects of insurance coverage on final outcome measures of actual health (e.g., infant mortality, days of work lost due to illness, or life expectancy) or intermediate outcomes (e.g., use of preventive health care or health care costs) could also be investigated.

Income security, Social Security, and veterans benefits and services. Major tax expenditures in the income security function benefit retirement savings, through employer-provided pensions, individual retirement accounts, and Keogh plans. These provisions might be evaluated in terms of their effects on boosting retirement incomes, private savings, and national savings (which would include the effect on private savings as well as public savings or deficits). Interactions with other programs, including Social Security, also may merit analysis. As in the case of employer-provided health insurance, analysis of employer-provided pension programs requires imputing the value of benefits funded at the firm level to individuals.

Other provisions principally affect the incomes of members of certain groups, rather than affecting incentives. For example, tax-favored treatment of Social Security benefits, certain veterans' benefits, and deductions for the blind and elderly provide increased incomes to eligible parties. The earned-income tax credit, in contrast, should be evaluated for its effects on labor force participation as well as the income it provides lower-income workers.

General purpose fiscal assistance and interest. The tax-exemption for public purpose State and local bonds reduces the costs of borrowing for a variety of purposes (borrowing for non-public purposes is reflected under other budget functions). The deductibility of certain State and local taxes reflected under this function primarily relates to personal income taxes (property tax deductibility is reflected under the commerce and housing function). Tax preferences for Puerto Rico and other U.S. possessions are also included here. These provisions can be compared with other tax and spending policies as means of benefiting fiscal and economic conditions in the States, localities, and possessions. Finally, the tax deferral for interest on U.S. savings bonds benefits savers who invest in these instruments. The extent of these benefits and any effects on Federal borrowing costs could be evaluated.

The above illustrative discussion, although broad, is nevertheless incomplete, omitting important details both for the provisions mentioned and the many that are not explicitly cited. Developing a framework that is sufficiently comprehensive, accurate, and flexible to reflect the objectives and effects of the wide range of tax expenditures will be a significant challenge. OMB, Treasury, and other agencies will work together, as appropriate, to address this challenge. As indicated above, over the next few years the Executive Branch's focus will be on the availability of the data needed to assess the effects of the tax expenditures designed to increase savings.

Descriptions of Income Tax Provisions

Descriptions of the individual and corporate income tax expenditures reported on in this chapter follow. These descriptions relate to current law as of December 31, 2005, and do not reflect proposals made elsewhere in the Budget. Legislation enacted in 2005, such as the Safe, Accountable, Flexible, Efficient Transportation Equity Act: A Legacy For Users, The Energy Tax Incentives Act of 2005, The Katrina Emergency Tax Relief Act of 2005, and the Gulf Opportunity Zone Act of 2005, expanded the scope of existing tax expenditures and introduced several new provisions. These include: (1) Exclusion of interest on clean renewable energy bonds; (2) Deferral of gain from dispositions of transmission property to implement FERC restructuring policy; (3) Credit for production from advanced nuclear power facilities; (4) Credit for investment in clean coal facilities; (5) Temporary 50 percent expensing for equipment used in the refining of liquid fuels; (6) Pass-through low-sulfur diesel expensing to cooperative owners; (7) Natural gas distribution pipelines treated as 15-year property; (8) Amortize all geological and geophysical expenditures over 2 years; (9) Allowance of deduction for certain energy efficient commercial building property; (10) Credit for construction of new energy efficient homes; (11) Credit for energy efficiency improvements to existing homes; (12) Credit for energy efficient appliances; (13) 30 percent credit for residential purchases/installations of solar and fuel cells; (14) Credit for business installation of qualified fuel cells and stationary microturbine power plants; (15) Business solar investment tax credit; (16) Alternative motor vehicle credit; (17) Credit for installation of alternative fueling stations; (18) Small agri-biodiesel producer credit; (19) Alternative fuel and fuel mixture tax credit; (20) Exclusion of interest spread of financial institutions; (21) Exclusion of interest on bonds for financing of highway projects and rail-truck transfer facilities; and (22) expanded and extended scope of a number of existing benefits to taxpayers in areas affected by hurricanes Katrina, Rita, and Wilma.

National Defense

1. ***Benefits and allowances to armed forces personnel***.—The housing and meals provided military personnel, either in cash or in kind, as well as certain amounts of pay related to combat service, are excluded from income subject to tax.

International Affairs

2. ***Income earned abroad***.—U.S. citizens who lived abroad, worked in the private sector, and satisfied a foreign residency requirement may exclude up to $80,000 in foreign earned income from U.S. taxes. In addition, if these taxpayers receive a specific allowance for foreign housing from their employers, they may also exclude the value of that allowance. If they do not receive a specific allowance for housing expenses, they may deduct against their U.S. taxes that portion of such expenses that exceeds one-sixth the salary of a civil servant at grade GS–14, step 1 ($76,193 in 2005).

3. ***Exclusion of certain allowances for Federal employees abroad***.—U.S. Federal civilian employees and Peace Corps members who work outside the continental United States are allowed to exclude from U.S. taxable income certain special allowances they receive to compensate them for the relatively high costs associated with living overseas. The allowances supplement wage income and cover expenses like rent, education, and the cost of travel to and from the United States.

4. ***Extraterritorial income exclusion***.[6]—The exclusion for extraterritorial income was repealed by the American Jobs Creation Act of 2004. Under the transition rules, taxpayers retain 80% of ETI benefits for 2005, 60% of ETI benefits for 2006, and no ETI benefits thereafter. The exclusion for extraterritorial income remains in effect for certain transactions which occur pursuant to a binding contract entered into on or before September 17, 2003.

5. ***Sales source rule exceptions***.—The worldwide income of U.S. persons is taxable by the United States and a credit for foreign taxes paid is allowed. The amount of foreign taxes that can be credited is limited to the pre-credit U.S. tax on the foreign source income. The sales source rules for inventory property allow U.S. exporters to use more foreign tax credits by allowing the exporters to attribute a larger portion of their earnings abroad than would be the case if the allocation of earnings was based on actual economic activity.

6. ***Income of U.S.-controlled foreign corporations***.—The income of foreign corporations controlled by U.S. shareholders is not subject to U.S. taxation. The income becomes taxable only when the controlling U.S. shareholders receive dividends or other distributions from their foreign stockholding. Under the normal tax method, the currently attributable foreign source pre-tax income from such a controlling interest is considered to be subject to U.S. taxation, whether or not distributed. Thus, the normal tax method considers the amount of controlled foreign corporation income not yet distributed to a U.S. shareholder as tax-deferred income.

7. ***Exceptions under subpart F for active financing income***.—Financial firms can defer taxes on income earned overseas in an active business. Taxes on income earned through December 31, 2006 can be deferred.

General Science, Space, and Technology

8. ***Expensing R&E expenditures***.—Research and experimentation (R&E) projects can be viewed as investments because, if successful, their benefits accrue for several years. It is often difficult, however, to identify whether a specific R&E project is successful and, if successful, what its expected life will be. Under the normal tax method, the expensing of R&E expenditures is viewed as a tax expenditure. The baseline assumed for the normal tax method is that all R&E expenditures are successful and have an expected life of five years.

9. ***R&E credit***.—The research and experimentation (R&E) credit is 20 percent of qualified research expenditures in excess of a base amount. The base amount is generally determined by multiplying a "fixed-base percentage" by the average amount of the company's gross receipts for the prior four years. The taxpayer's fixed base percentage generally is the ratio of its research expenses to gross receipts for 1984 through 1988. Taxpayers may also elect an alternative credit regime. Under the alternative credit regime the taxpayer is assigned a three-tiered fixed-base percentage that is lower than the fixed-base percentage that would otherwise apply, and the credit rate is reduced (the rates range from 2.65 percent to 3.75 percent). A 20-percent credit with a separate threshold is provided

[6] The determination of whether a provision is a tax expenditure is made on the basis of a broad concept of "income" that is larger in scope than is "income" as defined under general U.S. income tax principles. For that reason, the tax expenditure estimates include, for example, estimates related to the exclusion of extraterritorial income, as well as other exclusions, notwithstanding that such exclusions define income under the general rule of U.S. income taxation.

for a taxpayer's payments to universities for basic research. A 20-percent "flat" credit with no threshold base amount is available for energy research expenditures paid to certain research consortia. The credit applies to research conducted before January 1, 2006 and extends to research conducted in Puerto Rico and the U.S. possessions.

Energy

10. ***Exploration and development costs***.—For successful investments in domestic oil and gas wells, intangible drilling costs (e.g., wages, the costs of using machinery for grading and drilling, the cost of unsalvageable materials used in constructing wells) may be expensed rather than amortized over the productive life of the property. Integrated oil companies may deduct only 70 percent of such costs and must amortize the remaining 30 percent over five years. The same rule applies to the exploration and development costs of surface stripping and the construction of shafts and tunnels for other fuel minerals.

11. ***Percentage depletion***.—Independent fuel mineral producers and royalty owners are generally allowed to take percentage depletion deductions rather than cost depletion on limited quantities of output. Under cost depletion, outlays are deducted over the productive life of the property based on the fraction of the resource extracted. Under percentage depletion, taxpayers deduct a percentage of gross income from mineral production at rates of 22 percent for uranium; 15 percent for oil, gas and oil shale; and 10 percent for coal. The deduction is limited to 50 percent of net income from the property, except for oil and gas where the deduction can be 100 percent of net property income. Production from geothermal deposits is eligible for percentage depletion at 65 percent of net income, but with no limit on output and no limitation with respect to qualified producers. Unlike depreciation or cost depletion, percentage depletion deductions can exceed the cost of the investment.

12. ***Alternative fuel production credit***.—A credit of $3 per oil-equivalent barrel of production (in 1979 dollars) is provided for gas produced from biomass and liquid, gaseous, or solid synthetic fuels produced from coal. The credit is generally available if the price of oil stays below $29.50 (in 1979 dollars). The credit applies only to fuel (1) produced at a facility placed in service before July 1, 1998, and (2) sold before January 1, 2008.

13. ***Oil and gas exception to passive loss limitation***.—Owners of working interests in oil and gas properties are exempt from the "passive income" limitations. As a result, the working interest-holder, who manages on behalf of himself and all other owners the development of wells and incurs all the costs of their operation, may aggregate negative taxable income from such interests with his income from all other sources.

14. ***Capital gains treatment of royalties on coal***.—Sales of certain coal under royalty contracts can be treated as capital gains rather than ordinary income.

15. ***Energy facility bonds***.—Interest earned on State and local bonds used to finance construction of certain energy facilities is tax-exempt. These bonds are generally subject to the State private-activity bond annual volume cap.

16. ***Enhanced oil recovery credit***.—A credit is provided equal to 15 percent of the taxpayer's costs for tertiary oil recovery on U.S. projects. Eligible costs include the cost of constructing a gas treatment plant to prepare Alaska natural gas for pipeline transportation and any of the following costs with respect to a qualified EOR project: (1) the cost of depreciable or amortizable tangible property that is an integral part of the project; (2) intangible drilling costs (IDCs) that the taxpayer can elect to deduct; and (3) deductible tertiary injectant costs. The credit rate is reduced in taxable years following calendar years during which the annual average unregulated wellhead price per barrel of domestic crude oil exceeds an inflation adjusted threshold of $28 (adjusted for inflation).

17. ***New technology, refined coal, Indian coal and coke and coke gas credits***.—A credit is provided equal to 10 percent of the basis of solar property (30 percent for purchases beginning in 2006 through 2007) and 10 percent of the basis of geothermal property placed in service during the taxable year. Equipment that uses fiber-optic distributed sunlight to illuminate the inside of a structure is solar energy property eligible for a 30 percent credit in 2006 and 2007. A credit is also available for certain electricity produced from wind energy, biomass, poultry waste, geothermal energy, solar energy, small irrigation power, municipal solid waste, or qualified hydropower and sold to an unrelated party. The credit rate in 2005 is 1.9 cents per kilowatt hour (0.9 cents per kilowatt hour for open-loop biomass, small irrigation power, municipal solid waste and qualified hydropower) and the rate is indexed in subsequent years. To qualify for the credit the electricity must be produced at a facility placed in service after a specified date (December 31, 1992, in the case of a closed-loop biomass facility, December 31, 1993, in the case of a wind energy facility, December 31, 1999, in the case of a poultry waste facility, August 8, 2005 in the case of qualified hydropower and October 22, 2004, in all other cases) and before January 1, 2006 for solar facilities and January 1, 2008 for all other qualifying facilities with the exception of hydropower facilities. To qualify for the credit, qualifying hydropower facilities must be placed in service before January 1, 2009. In addition, the electricity must be produced during the 10-year period after the facility is originally placed in service. A credit is available for refined coal produced at facilities placed in service during the period from October 22, 2004, through December 31, 2008, and sold during the 10-year period beginning on the date the facility was placed in service. The credit rate in 2005 is $5.481 per ton and the rate is indexed in subsequent years. A credit is available for Indian coal. The taxpayer may claim a credit for sales of coal to an unrelated third party from a quali-

fied facility for the seven-year period beginning on January 1, 2006, and ending after December 31, 2012. The value of the credit is $1.50 per ton for the first four years of the seven-year production period and $2.00 per ton for the last three years of the seven-year period. The credit amounts are indexed for inflation. A credit is available for the production of coke or coke gas from a qualified facility. Qualified facilities must have been placed in service before January 1, 1993, or after June 30, 1998, and before January 1, 2010.

18. ***Alcohol fuel credits***.—An income tax credit is provided for ethanol that is derived from renewable sources and used as fuel. The credit equals 51 cents per gallon through 2010. In lieu of the alcohol mixture credit, the taxpayer may claim a refundable excise tax credit. In addition, small ethanol producers are eligible for a separate 10 cents per gallon credit.

19. ***Credit and deduction for clean-fuel vehicles and property and alternative motor vehicle credits***.—A tax credit of 10 percent (not to exceed $4,000) is provided for purchasers of electric vehicles. The credit is reduced by 75 percent for vehicles placed in service in 2006 and is not available for vehicles placed in service after December 31, 2006. Purchasers of other clean-fuel burning vehicles and owners of clean-fuel refueling property may deduct part of their expenditures. No deduction is available to taxpayers for vehicles placed in service after December 31, 2005. The deduction for clean-fuel property is available for costs incurred before January 1, 2007. A taxpayer may claim a 30 percent credit for the cost of installing clean-fuel vehicle refueling property for property placed in service after December 31, 2005 and before January 1, 2008. The taxpayer may not claim deductions with respect to property for which the credit is claimed. A tax credit is also available for the purchase of hybrid vehicles, fuel cell vehicles, alternative fuel vehicles and advanced lean burn vehicles. The provision applies to vehicles placed in service after December 31, 2005, in the case of qualified fuel cell motor vehicles, before January 1, 2015; in the case of qualified hybrid motor vehicles that are automobiles and light trucks and in the case of advanced lean-burn technology vehicles, before January 1, 2011; in the case of qualified hybrid motor vehicles that are medium and heavy trucks, before January 1, 2010; and in the case of qualified alternative fuel motor vehicles, before January 1, 2011. A tax credit is available for the purchase of hybrid vehicles, fuel cell vehicles, alternative fuel vehicles and advanced lean burn vehicles. The provision applies to vehicles placed in service after December 31, 2005, in the case of qualified fuel cell motor vehicles, before January 1, 2015; in the case of qualified hybrid motor vehicles that are automobiles and light trucks and in the case of advanced lean-burn technology vehicles, before January 1, 2011; in the case of qualified hybrid motor vehicles that are medium and heavy trucks, before January 1, 2010; and in the case of qualified alternative fuel motor vehicles, before January 1, 2011.

20. ***Exclusion of utility conservation subsidies***.—Non-business customers can exclude from gross income subsidies received from public utilities for expenditures on energy conservation measures.

21. ***Credit to holders of clean renewable energy bonds***.—The Energy Tax Incentives Act of 2005 introduced this provision which provides for up to $800 million in aggregate issuance of Clean Renewable Energy Bonds (CREBs) through December 31, 2007. Taxpayers holding CREBs on a credit allowance date are entitled to a tax credit.

22. ***Deferral of gain from dispositions of transmission property to implement FERC restructuring policy***.—Utilities that sell their transmission assets to a FERC-approved independent transmission company are allowed a longer recognition period for their gains from sale. Rather than paying tax on any gain from the sale in the year that the sale is completed, utilities will have 8 years to pay the tax on any gain from the sale. The rule expires at the end of 2007.

23. ***Credit for production from advanced nuclear power facilities***.—This provision was introduced by the Energy Tax Incentives Act of 2005. A taxpayer producing electricity at a qualifying advanced nuclear power facility may claim a credit equal to 1.8 cents per kilowatt-hour of electricity produced for the eight-year period starting when the facility is placed in service, limited no more than $125 million in tax credits per 1,000 megawatts of allocated capacity in any one year.

24. ***Credit for investment in clean coal facilities***.—This provision was introduced by the Energy Tax Incentives Act of 2005. Three investment tax credits for clean coal facilities are available: a 15 percent and 20 percent investment tax credit for clean coal facilities producing electricity; and a 20 percent credit for industrial gasification projects. Integrated gasification combined cycle (IGCC) projects get a 20 percent investment tax credit and other advanced coal-based projects that produce electricity get a 15 percent credit. The Secretary of the Treasury may allocate up to $800 million for IGCC projects and up to $500 million for other advanced coal-based technologies and up to $350 million for industrial gasification.

25. ***Temporary 50 percent expensing for equipment used in the refining of liquid fuels***.—This provision was introduced by the Energy Tax Incentives Act of 2005. Taxpayers may expense 50 percent of the cost of refinery investments which increase the capacity of an existing refinery by at least 5 percent or increase the throughput of qualified fuels by at least 25 percent. Qualified fuels include oil from shale and tar sands. Investments must be placed in service before January 1, 2012.

26. ***Pass through low sulfur diesel expensing to cooperative owners***.—This provision was introduced by the Energy Tax Incentives Act of 2005. Taxpayers may expense certain costs for investments to comply with EPA low sulfur diesel regulations. The deduction

may be passed-through to members of a cooperative if the cooperative makes an election on their tax return.

27. ***Natural gas distribution pipelines treated as 15-year property***.—This provision was introduced by the Energy Tax Incentives Act of 2005. The depreciation period is shortened to 15 years for any gas distribution lines the original use of which occurred after April 11, 2004 and before January 1, 2011. The provision does not apply to any property which the taxpayer or a related party had entered into a binding contract for the construction thereof or self-constructed on or before April 11, 2005.

28. ***Amortize all geological and geophysical expenditures over 2 years***.—This provision was introduced by the Energy Tax Incentives Act of 2005. Geological and geophysical amounts incurred in connection with oil and gas exploration in the United States may be amortized over two years. In the case of abandoned property, any remaining basis may no longer be recovered in the year of abandonment of a property as all basis is recovered over the two-year amortization period.

29. ***Allowance of deduction for certain energy efficient commercial building property***.—This provision was introduced by the Energy Tax Incentives Act of 2005. A deduction for energy efficient commercial buildings that reduce annual energy and power consumption by 50 percent compared to the American Society of Heating, Refrigerating, and Air Conditioning Engineers (ASHRAE) standard is allowed. The provision is effective for property placed in service after December 31, 2005 and prior to January 1, 2008.

30. ***Credit for construction of new energy efficient homes***.—This provision was introduced by the Energy Tax Incentives Act of 2005. A credit is available to eligible contractors for construction of a qualified new energy-efficient home. The credit applies to homes whose construction is substantially completed after December 31, 2005 and which are purchased after December 31, 2005 and prior to January 1, 2008.

31. ***Credit for energy efficiency improvements to existing homes***.—This provision was introduced by the Energy Tax Incentives Act of 2005. A 10 percent investment tax credit for expenditures with respect to improvements to building envelope is available. Credits for purchases of advanced main air circulating fans, natural gas, propane, or oil furnaces or hot water boilers, and other qualified energy efficient property are also available. Credit applies to property placed in service after December 31, 2005 and prior to January 1, 2008.

32. ***Credit for energy efficient appliances***.—This provision was introduced by the Energy Tax Incentives Act of 2005. Tax credits for the manufacture of efficient dishwashers, clothes washers, and refrigerators are available. Credits vary depending on the efficiency of the unit. The provision is effective for appliances manufactured in 2006 and 2007.

33. ***Credit for residential purchases/installations of solar and fuel cells***.—This provision was introduced by the Energy Tax Incentives Act of 2005. A credit, equal to 30 percent of qualifying expenditures, for purchase for qualified photovoltaic property and solar water heating property is available. A 30 percent credit for the purchase of qualified fuel cell power plants is also allowed and applies to property placed in service after December 31, 2005 and prior to January 1, 2008.

34. ***Credit for business installation of qualified fuel cells and stationary microturbine power plants***.—This provision was introduced by the Energy Tax Incentives Act of 2005. A 30 percent business energy credit for purchase of qualified fuel cell power plants for businesses and a 10 percent credit for purchase of qualifying stationary microturbine power plants are allowed.

35. ***Alternative fuel and fuel mixture tax credit***.—This provision was introduced in the Safe, Accountable, Flexible, Efficient Transportation Equity Act of 2005. A tax credit is available against the excise tax imposed on the retail sale or use of alternative fuels or mixture of alternative fuel and other taxable fuel. The credit is 50 cents per gallon of alternative fuel.

Natural Resources and Environment

36. ***Exploration and development costs***.—Certain capital outlays associated with exploration and development of nonfuel minerals may be expensed rather than depreciated over the life of the asset.

37. ***Percentage depletion***.—Most nonfuel mineral extractors may use percentage depletion rather than cost depletion, with percentage depletion rates ranging from 22 percent for sulfur to 5 percent for sand and gravel.

38. ***Sewage, water, solid and hazardous waste facility bonds***.—Interest earned on State and local bonds used to finance the construction of sewage, water, or hazardous waste facilities is tax-exempt. These bonds are generally subject to the State private-activity bond annual volume cap.

39. ***Capital gains treatment of certain timber***.—Certain timber sales can be treated as a capital gain rather than ordinary income.

40. ***Expensing multiperiod timber growing costs***.—Most of the production costs of growing timber may be expensed rather than capitalized and deducted when the timber is sold. In most other industries, these costs are capitalized under the uniform capitalization rules.

41. ***Historic preservation***.—Expenditures to preserve and restore historic structures qualify for a 20-percent investment credit, but the depreciable basis must be reduced by the full amount of the credit taken.

42. ***Expensing of capital costs with respect to complying with EPA sulfur regulations***.—Small refiners are allowed to deduct 75 percent of qualified capital costs incurred by the taxpayer during the taxable year. This provision was introduced by the American Jobs Creation Act (AJCA) enacted in 2004.

43. ***Exclusion of gain or loss on sale or exchange of certain brownfield sites***.—In general, an organization that is otherwise exempt from federal income tax is taxed on income from any trade or business regularly carried on by the organization that is not substantially related to the organization's exempt purpose. The AJCA of 2004 created a special exclusion from unrelated business taxable income of the gain or loss from the sale or exchange of certain qualifying brownfield properties. The exclusion applies regardless of whether the property is debt-financed. In order to qualify, a minimum amount of remediation expenditures must be incurred by the organization.

Agriculture

44. ***Expensing certain capital outlays***.—Farmers, except for certain agricultural corporations and partnerships, are allowed to expense certain expenditures for feed and fertilizer, as well as for soil and water conservation measures. Expensing is allowed, even though these expenditures are for inventories held beyond the end of the year, or for capital improvements that would otherwise be capitalized.

45. ***Expensing multiperiod livestock and crop production costs***.—The production of livestock and crops with a production period of less than two years is exempt from the uniform cost capitalization rules. Farmers establishing orchards, constructing farm facilities for their own use, or producing any goods for sale with a production period of two years or more may elect not to capitalize costs. If they do, they must apply straight-line depreciation to all depreciable property they use in farming.

46. ***Loans forgiven solvent farmers***.—Farmers are forgiven the tax liability on certain forgiven debt. Normally, debtors must include the amount of loan forgiveness as income or reduce their recoverable basis in the property to which the loan relates. If the debtor elects to reduce basis and the amount of forgiveness exceeds the basis in the property, the excess forgiveness is taxable. For insolvent (bankrupt) debtors, however, the amount of loan forgiveness reduces carryover losses, then unused credits, and then basis; any remainder of the forgiven debt is excluded from tax. Farmers with forgiven debt are considered insolvent for tax purposes, and thus qualify for income tax forgiveness.

47. ***Capital gains treatment of certain income***.—Certain agricultural income, such as unharvested crops, can be treated as capital gains rather than ordinary income.

48. ***Income averaging for farmers***.—Taxpayers can lower their tax liability by averaging, over the prior three-year period, their taxable income from farming and fishing.

49. ***Deferral of gain on sales of farm refiners***.—A taxpayer who sells stock in a farm refiner to a farmers' cooperative can defer recognition of gain if the taxpayer reinvests the proceeds in qualified replacement property.

50. ***Bio-Diesel tax credit***.—An income tax credit of $0.50, similar to Ethanol benefits, is available for each gallon of biodiesel used or sold. Biodiesel derived from virgin sources (agri-biodiesel) receives an increased credit of $1.00 per gallon. The provision was introduced by the AJCA in 2004. The Energy Tax Incentives Act of 2005 extends the income tax credit, excise tax credit, and payment provisions through December 31, 2008 and adds a credit for small agri-biodiesel producers. The conference agreement also creates a similar income tax credit, excise tax credit and payment system for renewable diesel, however there is no credit for small producers of renewable diesel. Renewable diesel means diesel fuel derived form biomass using thermal depolymerization process.

Commerce and Housing

This category includes a number of tax expenditure provisions that also affect economic activity in other functional categories. For example, provisions related to investment, such as accelerated depreciation, could be classified under the energy, natural resources and environment, agriculture, or transportation categories.

51. ***Credit union income***.—The earnings of credit unions not distributed to members as interest or dividends are exempt from income tax.

52. ***Bad debt reserves***.—Small (less than $500 million in assets) commercial banks, mutual savings banks, and savings and loan associations may deduct additions to bad debt reserves in excess of actually experienced losses.

53. ***Deferral of income on life insurance and annuity contracts***.—Favorable tax treatment is provided for investment income within qualified life insurance and annuity contracts. Investment income earned on qualified life insurance contracts held until death is permanently exempt from income tax. Investment income distributed prior to the death of the insured is tax-deferred, if not tax-exempt. Investment income earned on annuities is treated less favorably than income earned on life insurance contracts, but it benefits from tax deferral without annual contribution or income limits generally applicable to other tax-favored retirement income plans.

54. ***Small property and casualty insurance companies***.—For taxable years beginning before January 1, 2004, insurance companies that were not life insurance companies and which had annual net premiums of less than $350,000 were exempt from tax; those with $350,000 to $1.2 million of annual net premiums could elect to pay tax only on the income earned by their taxable investment portfolio. For taxable years beginning after December 31, 2003, stock non-life insurance companies are generally exempt from tax if their gross receipts for the taxable year do not exceed $600,00 and more than 50 percent of such gross receipts consists of premiums. Mutual non-life insurance companies are generally tax-exempt if their annual gross receipts do not exceed $150,000 and more than 35 percent of gross receipts consist of premiums. Also, for taxable years

beginning after December 31, 2003, non-life insurance companies with no more than $1.2 million of annual net premiums may elect to pay tax only on their taxable investment income.

55. ***Insurance companies owned by exempt organizations***.—Generally, the income generated by life and property and casualty insurance companies is subject to tax, albeit by special rules. Insurance operations conducted by such exempt organizations as fraternal societies and voluntary employee benefit associations, however, are exempt from tax.

56. ***Small life insurance company deduction***.—Small life insurance companies (gross assets of less than $500 million) can deduct 60 percent of the first $3 million of otherwise taxable income. The deduction phases out for otherwise taxable income between $3 million and $15 million.

57. ***Exclusion of interest spread of financial institutions***.—Consumers and non-profit organizations pay for some deposit-linked services, such as check cashing, by accepting a below-market interest rate on their demand deposits. If they received a market rate of interest on those deposits and paid explicit fees for the associated services, they would pay taxes on the full market rate and (unlike businesses) could not deduct the fees. The government thus foregoes tax on the difference between the risk-free market interest rate and below-market interest rates on demand deposits, which under competitive conditions should equal the value added of deposit services.

58. ***Mortgage housing bonds***.—Interest earned on State and local bonds used to finance homes purchased by first-time, low-to-moderate-income buyers is tax-exempt. The amount of State and local tax-exempt bonds that can be issued to finance these and other private activity is limited. The combined volume cap for private activity bonds, including mortgage housing bonds, rental housing bonds, student loan bonds, and industrial development bonds was $62.50 per capita ($187.5 million minimum) per State in 2001, and $75 per capita ($225 million minimum) in 2002. The Community Renewal Tax Relief Act of 2000 accelerated the scheduled increase in the state volume cap and indexed the cap for inflation, beginning in 2003. States may issue mortgage credit certificates (MCCs) in lieu of mortgage revenue bonds. MCCs entitle home buyers to income tax credits for a specified percentage of interest on qualified mortgages. The total amount of MCCs issued by a State cannot exceed 25 percent of its annual ceiling for mortgage-revenue bonds.

59. ***Rental housing bonds***.—Interest earned on State and local government bonds used to finance multifamily rental housing projects is tax-exempt. At least 20 percent (15 percent in targeted areas) of the units must be reserved for families whose income does not exceed 50 percent of the area's median income; or 40 percent for families with incomes of no more than 60 percent of the area median income. Other tax-exempt bonds for multifamily rental projects are generally issued with the requirement that all tenants must be low or moderate income families. Rental housing bonds are subject to the volume cap discussed in the mortgage housing bond section above.

60. ***Interest on owner-occupied homes***.—Owner-occupants of homes may deduct mortgage interest on their primary and secondary residences as itemized nonbusiness deductions. The mortgage interest deduction is limited to interest on debt no greater than the owner's basis in the residence and, for debt incurred after October 13, 1987; it is limited to no more than $1 million. Interest on up to $100,000 of other debt secured by a lien on a principal or second residence is also deductible, irrespective of the purpose of borrowing, provided the debt does not exceed the fair market value of the residence. Mortgage interest deductions on personal residences are tax expenditures because the value of owner-occupied housing services is not included in a taxpayer's taxable income.

61. ***Taxes on owner-occupied homes***.—Owner-occupants of homes may deduct property taxes on their primary and secondary residences even though they are not required to report the value of owner-occupied housing services as gross income.

62. ***Installment sales***.—Dealers in real and personal property (i.e., sellers who regularly hold property for sale or resale) cannot defer taxable income from installment sales until the receipt of the loan repayment. Nondealers (i.e., sellers of real property used in their business) are required to pay interest on deferred taxes attributable to their total installment obligations in excess of $5 million. Only properties with sales prices exceeding $150,000 are includable in the total. The payment of a market rate of interest eliminates the benefit of the tax deferral. The tax exemption for nondealers with total installment obligations of less than $5 million is, therefore, a tax expenditure.

63. ***Capital gains exclusion on home sales***.—A homeowner can exclude from tax up to $500,000 ($250,000 for singles) of the capital gains from the sale of a principal residence. The exclusion may not be used more than once every two years.

64. ***Imputed net rental income on owner occupied housing***.—The implicit rental value of home ownership, net of expenses such as mortgage interest and depreciation, is excluded from income. The appendix provides a greater explanation of this new addition to the tax expenditure budget.

65. ***Passive loss real estate exemption***.—In general, passive losses may not offset income from other sources. Losses up to $25,000 attributable to certain rental real estate activity, however, are exempt from this rule.

66. ***Low-income housing credit***.—Taxpayers who invest in certain low-income housing are eligible for a tax credit. The credit rate is set so that the present value of the credit is equal to 70 percent for new construction and 30 percent for (1) housing receiving other Federal benefits (such as tax-exempt bond financing), or (2) substantially rehabilitated existing housing. The credit is allowed in equal amounts over 10 years. State

agencies determine who receives the credit; States are limited in the amount of credit they may authorize annually. The Community Renewal Tax Relief Act of 2000 increased the per-resident limit to $1.50 in 2001 and to $1.75 in 2002 and indexed the limit for inflation, beginning in 2003. The Act also created a $2 million minimum annual cap for small States beginning in 2002; the cap is indexed for inflation, beginning in 2003.

67. ***Accelerated depreciation of rental property***.—The tax depreciation allowance provisions are part of the reference law rules, and thus do not give rise to tax expenditures under the reference method. Under the normal tax method, however, economic depreciation is assumed. This calculation is described in more detail in the Appendix.

68. ***Cancellation of indebtedness***.—Individuals are not required to report the cancellation of certain indebtedness as current income. If the canceled debt is not reported as current income, however, the basis of the underlying property must be reduced by the amount canceled.

69. ***Imputed interest rules***.—Holders (issuers) of debt instruments are generally required to report interest earned (paid) in the period it accrues, not when paid. In addition, the amount of interest accrued is determined by the actual price paid, not by the stated principal and interest stipulated in the instrument. In general, any debt associated with the sale of property worth less than $250,000 is excepted from the general interest accounting rules. This general $250,000 exception is not a tax expenditure under reference law but is under normal law. Exceptions above $250,000 are a tax expenditure under reference law; these exceptions include the following: (1) sales of personal residences worth more than $250,000, and (2) sales of farms and small businesses worth between $250,000 and $1 million.

70. ***Capital gains (other than agriculture, timber, iron ore, and coal)***.—Capital gains on assets held for more than 1 year are taxed at a lower rate than ordinary income. Under the revised reference law baseline used for the 2005 Budget, the lower rate on capital gains is considered a tax expenditure under the reference law method, but only for capital gains that have not been previously taxed under the corporate income tax. As discussed above, this treatment partially adjusts for the double tax on corporate income and is more consistent with a comprehensive income tax base.

Prior to passage of the Jobs Growth Tax Relief Reconciliation Act (JGTRRA), the top capital gains tax rate for most assets held for more than 1 year was 20 percent. For assets acquired after December 31, 2000, the top capital gains tax rate for assets held for more than 5 years was 18 percent. Since January 1, 2001, taxpayers may mark-to-market existing assets to start the 5-year holding period. Losses from the mark-to-market are not recognized.

For assets held for more than 1 year by taxpayers in the 15-percent ordinary tax bracket, the top capital gains tax rate was 10 percent. After December 31, 2000, the top capital gains tax rate for assets held by these taxpayers for more than 5 years was 8 percent. JGTRRA reduced the previous 20 percent and 18 percent rates on net capital gains to 15 percent and the previous 10 percent and 8 percent rates to 5 percent (0 percent, in 2008). The lower rates apply to assets held for more than one year. The lower rates apply to assets sold after May 6, 2003 through 2008.

71. ***Capital gains exclusion for small business stock***.—An exclusion of 50 percent is provided for capital gains from qualified small business stock held by individuals for more than 5 years. A qualified small business is a corporation whose gross assets do not exceed $50 million as of the date of issuance of the stock.

72. ***Step-up in basis of capital gains at death***.—Capital gains on assets held at the owner's death are not subject to capital gains taxes. The cost basis of the appreciated assets is adjusted upward to the market value at the owner's date of death. After repeal of the estate tax for 2010 under the Economic Growth and Tax Relief Reconciliation Act (EGTRRA) of 2001, the basis for property acquired from a decedent will be the lesser of fair market value or the decedent's basis. Certain types of additions to basis will be allowed so that assets in most estates that are not currently subject to estate tax will not be subject to capital gains tax in the hands of the heirs.

73. ***Carryover basis of capital gains on gifts***.—When a gift is made, the donor's basis in the transferred property (the cost that was incurred when the transferred property was first acquired) carries-over to the donee. The carryover of the donor's basis allows a continued deferral of unrealized capital gains. Even though the estate tax is repealed for 2010 under EGTRRA, the gift tax is retained with a lifetime exemption of $1 million.

74. ***Ordinary income treatment of losses from sale of small business corporate stock shares***.—Up to $100,000 in losses from the sale of small business corporate stock (capitalization less than $1 million) may be treated as ordinary losses. Such losses would, thus, not be subject to the $3,000 annual capital loss write-off limit.

75. ***Accelerated depreciation of non-rental-housing buildings***.—The tax depreciation allowance provisions are part of the reference law rules, and thus do not give rise to tax expenditures under reference law. Under normal law, however, economic depreciation is assumed. This calculation is described in more detail in the Appendix.

76. ***Accelerated depreciation of machinery and equipment***.—The tax depreciation allowance provisions are part of the reference law rules, and thus do not give rise to tax expenditures under reference law. Under the normal tax baseline, this tax depreciation allowance is measured relative to economic depreciation. This calculation is described in more detail in the Appendix.

77. ***Expensing of certain small investments***.—As of 2003, under prior law, qualifying investments in tangible property up to $25,000 could have been expensed rather than depreciated over time. The amount eligible for expensing was decreased to the extend the taxpayer's qualifying investment during the year exceeded $200,000. For 2003, however, the expensing limit was temporarily increased to $100,000, the phase-out limit was temporarily increased to $400,000, and computer software became temporarily eligible for expensing treatment. For 2004, through 2007, these higher limits are indexed for inflation, and computer software continues to be an eligible investment. In all years, the amount expensed cannot exceed the taxpayer's taxable income for the year. The prior rules will apply for taxable years beginning after 2007.

78. ***Graduated corporation income tax rate schedule***.—The corporate income tax schedule is graduated, with rates of 15 percent on the first $50,000 of taxable income, 25 percent on the next $25,000, and 34 percent on the next $9.925 million. Compared with a flat 34-percent rate, the lower rates provide an $11,750 reduction in tax liability for corporations with taxable income of $75,000. This benefit is recaptured for corporations with taxable incomes exceeding $100,000 by a 5-percent additional tax on corporate incomes in excess of $100,000 but less than $335,000.

The corporate tax rate is 35 percent on income over $10 million. Compared with a flat 35-percent tax rate, the 34-percent rate provides a $100,000 reduction in tax liability for corporations with taxable incomes of $10 million. This benefit is recaptured for corporations with taxable incomes exceeding $15 million by a 3-percent additional tax on income over $15 million but less than $18.33 million. Because the corporate rate schedule is part of reference tax law, it is not considered a tax expenditure under the reference method. A flat corporation income tax rate is taken as the baseline under the normal tax method; therefore the lower rates is considered a tax expenditure under this concept.

79. ***Small issue industrial development bonds***.—Interest earned on small issue industrial development bonds (IDBs) issued by State and local governments to finance manufacturing facilities is tax-exempt. Depreciable property financed with small issue IDBs must be depreciated, however, using the straight-line method. The annual volume of small issue IDBs is subject to the unified volume cap discussed in the mortgage housing bond section above.

80. ***Deduction for U.S. production activities***.—This provision was introduced by the AJCA in 2004 and allows for a deduction equal to a portion of taxable income attributable to domestic production. For taxable years beginning in 2004, 2005, 2006, 2007, and 2008, the amount of the deduction is 5, 5, 5, 6, and 7 percent, respectively. For taxable years beginning after 2008, the amount of the deduction is 9 percent.

81. ***Special rules for certain film and TV production***.—Taxpayers may deduct up to $15 million ($15 million in certain distressed areas) per production expenditures in the year incurred. Excess expenditures may be deducted over three years using the straight line method. This provision was introduced by the AJCA enacted in 2004. Under prior law, production expenses were depreciated.

Transportation

82. ***Deferral of tax on U.S. shipping companies***.—Certain companies that operate U.S. flag vessels can defer income taxes on that portion of their income used for shipping purposes, primarily construction, modernization and major repairs to ships, and repayment of loans to finance these investments. Once indefinite, the deferral has been limited to 25 years since January 1, 1987.

83. ***Exclusion of employee parking expenses***.—Employee parking expenses that are paid for by the employer or that are received in lieu of wages are excludable from the income of the employee. In 2005, the maximum amount of the parking exclusion is $200 (indexed) per month. The tax expenditure estimate does not include parking at facilities owned by the employer.

84. ***Exclusion of employee transit pass expenses***.—Transit passes, tokens, fare cards, and vanpool expenses paid for by an employer or provided in lieu of wages to defray an employee's commuting costs are excludable from the employee's income. In 2005, the maximum amount of the exclusion is $105 (indexed) per month.

85. ***Tax credit for certain expenditures for maintaining railroad tracks***.—Eligible taxpayers may claim a credit equal to the lesser of 50 percent of maintenance expenditures and the product of $3,500 and the number of miles of track owned or leased. This provision was introduced by the AJCA in 2004.

86. ***Exclusion of interest on bonds for Financing of Highway Projects and Rail-Truck Transfer Facilities***.—This provision provides for $15 billion of tax-exempt bond authority to finance qualified highway or surface freight transfer facilities. It was introduced by the Safe, Accountable, Flexible, Efficient Transportation Equity Act: A Legacy For Users enacted in 2005. The authority to issue these bonds expires on December 31, 2015.

Community and Regional Development

87. ***Rehabilitation of structures***.—A 10-percent investment tax credit is available for the rehabilitation of buildings that are used for business or productive activities and that were erected before 1936 for other than residential purposes. The taxpayer's recoverable basis must be reduced by the amount of the credit.

88. ***Airport, dock, and similar facility bonds***.—Interest earned on State and local bonds issued to finance high-speed rail facilities and government-owned airports, docks, wharves, and sport and convention facilities is tax-exempt. These bonds are not subject to a volume cap.

89. ***Exemption of income of mutuals and cooperatives***.—The incomes of mutual and cooperative telephone and electric companies are exempt from tax if at least 85 percent of their revenues are derived from patron service charges.

90. ***Empowerment zones and renewal communities***.—Qualifying businesses in designated economically depressed areas can receive tax benefits such as an employer wage credit, increased expensing of investment in equipment, special tax-exempt financing, accelerated depreciation, and certain capital gains incentives. Empowerment zone and renewal community designations expire at the end of 2009. The Job Creation and Worker Assistance Act of 2002 expanded the existing provisions by adding the "New York City Liberty Zone." In addition, the Working Families Tax Relief Act of 2004 extended the District of Columbia Enterprise Zone and the District of Columbia first time homebuyer credit by two years through 2005.

The Gulf Opportunity Zone Act of 2005 added several provisions targeted to encourage the redevelopment of areas affected by hurricanes Katrina, Rita and Wilma, including some provisions that have already been listed elsewhere in this table. Gulf Opportunity Zone Act provisions not listed elsewhere include additional tax-exempt bond financing authority, accelerated depreciation of investment in both structures and equipment, partial expensing for certain demolition and clean-up costs, increased carryback of certain net operating losses, increased authority to allocate low-income housing tax credits and new markets tax credits within the affected areas and other provisions.

91. ***New markets tax credit***.—Taxpayers who make qualified equity investments in a community development entity (CDE), which then makes qualified investments in low-income communities, are eligible for a tax credit received over 7 years. The amount of the credit equals (1) 5 percent in the year of purchase and the following 2 years, and (2) 6 percent in the following 4 years. A CDE is any domestic firm whose primary mission is to serve or provide investment capital for low-income communities/individuals; a CDE must be accountable to residents of low-income communities. The total equity investment available for the credit across all CDEs is $1.0 billion in 2001, $1.5 billion in 2002 and 2003, $2.0 billion in 2004 and 2005, and $3.5 billion in 2006 and 2007. Credit authority is allocated to CDEs through a competitive application process.

92. ***Expensing of environmental remediation costs***.—Taxpayers who clean up certain hazardous substances at a qualified site may expense the clean-up costs, even though the expenses will generally increase the value of the property significantly or appreciably prolong the life of the property. The Working Families Tax Relief Act of 2004 extended this provision for two years, allowing remediation expenditures incurred before December 31, 2005 to be eligible for expensing.

The Gulf Opportunity Zone Act of 2005 extends this provision through December 31, 2007 for sites located in the Gulf Opportunity Zone and expands the allowable costs to include petroleum product remediation.

93. ***Credit to holders of Gulf Tax Credit Bonds***.—Taxpayers that own Gulf Tax Credit bonds receive a non-refundable tax credit (at a rate set by the Treasury Department) rather than interest. The credit is included in gross income. The maximum amount that can be issued is $200 million in the case of Louisiana, $100 million in the case of Mississippi, and $50 million in the case of Alabama.

Education, Training, Employment, and Social Services

94. ***Scholarship and fellowship income***.—Scholarships and fellowships are excluded from taxable income to the extent they pay for tuition and course-related expenses of the grantee. Similarly, tuition reductions for employees of educational institutions and their families are not included in taxable income. From an economic point of view, scholarships and fellowships are either gifts not conditioned on the performance of services, or they are rebates of educational costs. Thus, under the reference law method, this exclusion is not a tax expenditure because this method does not include either gifts or price reductions in a taxpayer's gross income. The exclusion, however, is considered a tax expenditure under the normal tax method, which includes gift-like transfers of Government funds in gross income (many scholarships are derived directly or indirectly from Government funding).

95. ***HOPE tax credit***.—The non-refundable HOPE tax credit allows a credit for 100 percent of an eligible student's first $1,000 of tuition and fees and 50 percent of the next $1,000 of tuition and fees. The credit only covers tuition and fees paid during the first two years of a student's post-secondary education. In 2005, the credit is phased out ratably for taxpayers with modified AGI between $87,000 and $107,000 ($43,000 and $53,000 for singles), indexed.

96. ***Lifetime Learning tax credit***.—The non-refundable Lifetime Learning tax credit allows a credit for 20 percent of an eligible student's tuition and fees, up to a maximum credit per return is $2,000. The credit is phased out ratably for taxpayers with modified AGI between $87,000 and $107,000 ($43,000 and $53,000 for singles) (indexed beginning in 2002). The credit applies to both undergraduate and graduate students.

97. ***Deduction for Higher Education Expenses***.—The maximum annual deduction for qualified higher education expenses is $4,000 in 2005 for taxpayers with adjusted gross income up to $130,000 on a joint return ($65,000 for singles). Taxpayers with adjusted gross income up to $160,000 on a joint return ($80,000 for singles) may deduct up to $2,000 beginning in 2004. No deduction is allowed for expenses paid after December 31, 2005.

98. ***Education Individual Retirement Accounts***.—Contributions to an education IRA are not tax-deductible. Investment income earned by education IRAs is not taxed when earned, and investment income from

an education IRA is tax-exempt when withdrawn to pay for a student's tuition and fees. The maximum contribution to an education IRA in 2005 is $2000 per beneficiary. The maximum contribution is phased down ratably for taxpayers with modified AGI between $190,000 and $220,000 ($95,000 and $110,000 for singles).

99. ***Student-loan interest***.—Taxpayers may claim an above-the-line deduction of up to $2,500 on interest paid on an education loan. Interest may only be deducted for the first five years in which interest payments are required. In 2005, the maximum deduction is phased down ratably for taxpayers with modified AGI between $105,000 and $135,000 ($50,000 and $65,000 for singles), indexed.

100. ***State prepaid tuition plans***.—Some States have adopted prepaid tuition plans and prepaid room and board plans, which allow persons to pay in advance for college expenses for designated beneficiaries. In 2001 taxes on the earnings from these plans are paid by the beneficiaries and are deferred until tuition is actually paid. Beginning in 2002, investment income is not taxed when earned, and is tax-exempt when withdrawn to pay for qualified expenses.

101. ***Student-loan bonds***.—Interest earned on State and local bonds issued to finance student loans is tax-exempt. The volume of all such private activity bonds that each State may issue annually is limited.

102. ***Bonds for private nonprofit educational institutions***.—Interest earned on State and local Government bonds issued to finance the construction of facilities used by private nonprofit educational institutions is not taxed.

103. ***Credit for holders of zone academy bonds***.—Financial institutions that own zone academy bonds receive a non-refundable tax credit (at a rate set by the Treasury Department) rather than interest. The credit is included in gross income. Proceeds from zone academy bonds may only be used to renovate, but not construct, qualifying schools and for certain other school purposes. The total amount of zone academy bonds that may be issued is limited to $1.6 billion—$400 million in each year from 1998 to 2005.

104. ***U.S. savings bonds for education***.—Interest earned on U.S. savings bonds issued after December 31, 1989 is tax-exempt if the bonds are transferred to an educational institution to pay for educational expenses. The tax exemption is phased out for taxpayers with AGI between $91,850 and $121.850 ($61,200 and $76,200 for singles) in 2005.

105. ***Dependent students age 19 or older***.—Taxpayers may claim personal exemptions for dependent children who are over the age of 18 or under the age of 24 and who (1) reside with the taxpayer for over half the year (with exceptions for temporary absences from home, such as for school attendance), (2) are full-time students, and (3) do not claim a personal exemption on their own tax returns.

106. ***Charitable contributions to educational institutions***.—Taxpayers may deduct contributions to nonprofit educational institutions. Taxpayers who donate capital assets to educational institutions can deduct the asset's current value without being taxed on any appreciation in value. An individual's total charitable contribution generally may not exceed 50 percent of adjusted gross income; a corporation's total charitable contributions generally may not exceed 10 percent of pre-tax income.

107. ***Employer-provided educational assistance***.—Employer-provided educational assistance is excluded from an employee's gross income even though the employer's costs for this assistance are a deductible business expense. EGTRRA permanently extended this exclusion and extended the exclusion to also include graduate education (beginning in 2002).

108. ***Special deduction for teacher expenses***.—Educators in both public and private elementary and secondary schools, who work at least 900 hours during a school year as a teacher, instructor, counselor, principal or aide, may subtract up to $250 of qualified expenses when figuring their adjusted gross income (AGI).

109. ***Discharge of student loan indebtedness***.—Certain professionals who perform in underserved areas, and as a consequence get their student loans discharged, may not recognize such discharge as income. This provision was expanded by the AJCA to include health professionals.

110. ***Work opportunity tax credit***.—Employers can claim a tax credit for qualified wages paid to individuals who begin work on or before December 31, 2005 and who are certified as members of various targeted groups. The amount of the credit that can be claimed is 25 percent for employment of less than 400 hours and 40 percent for employment of 400 hours or more. The maximum credit per employee is $2,400 and can only be claimed on the first year of wages an individual earns from an employer. Employers must reduce their deduction for wages paid by the amount of the credit claimed. The Katrina Emergency Tax Relief Act of 2005 expanded WOTC eligibility to Hurricane Katrina Employees, defined as persons whose principal places of abode on August 28, 2005 were in the core disaster area and who beginning on such date and through August 28, 2007, are hired for a position principally located in the core disaster area; and beginning on such date and through December 31, 2005, are hired for a position regardless of its location. The usual certification process rules are waived for Hurricane Katrina employees.

111. ***Welfare-to-work tax credit***.—An employer is eligible for a tax credit on the first $20,000 of eligible wages paid to qualified long-term family assistance recipients during the first two years of employment. The credit is 35 percent of the first $10,000 of wages in the first year of employment and 50 percent of the first $10,000 of wages in the second year of employment. The maximum credit is $8,500 per employee. The credit applies to wages paid to employees who are hired on or before December 31, 2005.

112. ***Employer-provided child care exclusion***.—Up to $5,000 of employer-provided child care is excluded from an employee's gross income even though the employer's costs for the child care are a deductible business expense.

113. ***Employer-provided child care credit***.—Employers can deduct expenses for supporting child care or child care resource and referral services. EGTRRA provides a tax credit to employers for qualified expenses beginning in 2002. The credit is equal to 25 percent of qualified expenses for employee child care and 10 percent of qualified expenses for child care resource and referral services. Employer deductions for such expenses are reduced by the amount of the credit. The maximum total credit is limited to $150,000 per taxable year.

114. ***Assistance for adopted foster children***.—Taxpayers who adopt eligible children from the public foster care system can receive monthly payments for the children's significant and varied needs and a reimbursement of up to $2,000 for nonrecurring adoption expenses. These payments are excluded from gross income.

115. ***Adoption credit and exclusion***.—Taxpayers can receive a nonrefundable tax credit for qualified adoption expenses. The maximum credit is $10,630 per child for 2005, and is phased-out ratably for taxpayers with modified AGI between $159,450 and $199,450. The credit amounts and the phase-out thresholds are indexed for inflation beginning in 2003. Unused credits may be carried forward and used during the five subsequent years. Taxpayers may also exclude qualified adoption expenses from income, subject to the same maximum amounts and phase-out as the credit. The same expenses cannot qualify for tax benefits under both programs; however, a taxpayer may use the benefits of the exclusion and the tax credit for different expenses. Stepchild adoptions are not eligible for either benefit.

116. ***Employer-provided meals and lodging***.—Employer-provided meals and lodging are excluded from an employee's gross income even though the employer's costs for these items are a deductible business expense.

117. ***Child credit***.—Taxpayers with children under age 17 can qualify for a $1,000 partially refundable per child credit. The maximum credit declines to $500 in 2011 and later years. The credit is phased out for taxpayers at the rate of $50 per $1,000 of modified AGI above $110,000 ($75,000 for singles).

118. ***Child and dependent care expenses***.—Married couples with child and dependent care expenses may claim a tax credit when one spouse works full time and the other works at least part time or goes to school. The credit may also be claimed by single parents and by divorced or separated parents who have custody of children. Expenditures up to a maximum $3,000 for one dependent and $6,000 for two or more dependents are eligible for the credit. The credit is equal to 35 percent of qualified expenditures for taxpayers with incomes of $15,000. The credit is reduced to a minimum of 20 percent by one percentage point for each $2,000 of income in excess of $15,000.

119. ***Disabled access expenditure credit***.—Small businesses (less than $1 million in gross receipts or fewer than 31 full-time employees) can claim a 50-percent credit for expenditures in excess of $250 to remove access barriers for disabled persons. The credit is limited to $5,000.

120. ***Charitable contributions, other than education and health***.—Taxpayers may deduct contributions to charitable, religious, and certain other nonprofit organizations. Taxpayers who donate capital assets to charitable organizations can deduct the assets' current value without being taxed on any appreciation in value. An individual's total charitable contribution generally may not exceed 50 percent of adjusted gross income; a corporation's total charitable contributions generally may not exceed 10 percent of pre-tax income.

121. ***Foster care payments***.—Foster parents provide a home and care for children who are wards of the State, under contract with the State. Compensation received for this service is excluded from the gross incomes of foster parents; the expenses they incur are nondeductible.

122. ***Parsonage allowances***.—The value of a minister's housing allowance and the rental value of parsonages are not included in a minister's taxable income.

123. ***Provide an employee retention credit to employers affected by hurricane Katrina, Rita, and Wilma***.—Businesses located within the Gulf Opportunity (GO) Zone on August 28, 2005 are eligible for a 40 percent tax credit on the first $6,000 in qualified wages paid to qualified employees employed within the GO Zone. Qualified wages are those paid by an eligible employer to an eligible employee on any day after August 28, 2005 and before January 1, 2006 during the period beginning on the date on which the trade or business first became inoperable at the principal place of employment of the employee by reason of hurricane Katrina and ending on the date on which such trade or business resumed significant operations at such principal place of employment. Similar rules apply to the Rita GO Zone and the Wilma GO Zone with initial effective dates of September 23, 2005, and October 23, 2005, respectively.

Health

124. ***Employer-paid medical insurance and expenses***.—Employer-paid health insurance premiums and other medical expenses (including long-term care) are deducted as a business expense by employers, but they are not included in employee gross income. The self-employed also may deduct part of their family health insurance premiums.

125. ***Self-employed medical insurance premiums***.—Self-employed taxpayers may deduct a percentage of their family health insurance premiums. Taxpayers without self-employment income are not eligible for the special percentage deduction. The deduct-

ible percentage is 60 percent in 2001, 70 percent in 2002, and 100 percent in 2003 and thereafter.

126. ***Medical and health savings accounts***.—Some employees may deduct annual contributions to a medical savings account (MSA); employer contributions to MSAs (except those made through cafeteria plans) for qualified employees are also excluded from income. An employee may contribute to an MSA in a given year only if the employer does not contribute to the MSA in that year. MSAs are only available to self-employed individuals or employees covered under an employer-sponsored high deductible health plan of a small employer. The maximum annual MSA contribution is 75 percent of the deductible under the high deductible plan for family coverage (65 percent for individual coverage). Earnings from MSAs are excluded from taxable income. Distributions from an MSA for medical expenses are not taxable. The number of taxpayers who may benefit annually from MSAs is generally limited to 750,000. No new MSAs may be established after December 31, 2003. The Medicare Prescription Drug, Improvement, and Modernization Act of 2003 introduced health savings accounts (HSA) which provides a tax-favored savings for health care expenses. The definition of a high-deductible health plan is less restrictive for HSAs than for MSAs.

127. ***Medical care expenses***.—Personal expenditures for medical care (including the costs of prescription drugs) exceeding 7.5 percent of the taxpayer's adjusted gross income are deductible.

128. ***Hospital construction bonds***.—Interest earned on State and local government debt issued to finance hospital construction is excluded from income subject to tax.

129. ***Charitable contributions to health institutions***.—Individuals and corporations may deduct contributions to nonprofit health institutions. Tax expenditures resulting from the deductibility of contributions to other charitable institutions are listed under the education, training, employment, and social services function.

130. ***Orphan drugs***.—Drug firms can claim a tax credit of 50 percent of the costs for clinical testing required by the Food and Drug Administration for drugs that treat rare physical conditions or rare diseases.

131. ***Blue Cross and Blue Shield***.—Blue Cross and Blue Shield health insurance providers in existence on August 16, 1986 and certain other nonprofit health insurers are provided exceptions from otherwise applicable insurance company income tax accounting rules that substantially reduce (or even eliminate) their tax liabilities.

132. ***Tax credit for health insurance purchased by certain displaced and retired individuals***.—The Trade Act of 2002 provided a refundable tax credit of 65 percent for the purchase of health insurance coverage by individuals eligible for Trade Adjustment Assistance and certain PBGC pension recipients.

Income Security

133. ***Railroad retirement benefits***.—Railroad retirement benefits are not generally subject to the income tax unless the recipient's gross income reaches a certain threshold. The threshold is discussed more fully under the Social Security function.

134. ***Workers' compensation benefits***.—Workers compensation provides payments to disabled workers. These benefits, although income to the recipients, are not subject to the income tax.

135. ***Public assistance benefits***.—Public assistance benefits are excluded from tax. The normal tax method considers cash transfers from the Government as taxable and, thus, treats the exclusion for public assistance benefits as a tax expenditure.

136. ***Special benefits for disabled coal miners***.—Disability payments to former coal miners out of the Black Lung Trust Fund, although income to the recipient, are not subject to the income tax.

137. ***Military disability pensions***.—Most of the military pension income received by current disabled retired veterans is excluded from their income subject to tax.

138. ***Employer-provided pension contributions and earnings***.—Certain employer contributions to pension plans are excluded from an employee's gross income even though the employer can deduct the contributions. In addition, the tax on the investment income earned by the pension plans is deferred until the money is withdrawn.

139. ***401(k) plans***.—Individual taxpayers can make tax-preferred contributions to certain types of employer-provided 401(k) plans (and 401(k)-type plans like 403(b) plans and the Federal government's Thrift Savings Plan). In 2004, an employee could exclude up to $14,000 of wages from AGI under a qualified arrangement with an employer's 401(k) plan. This increases to $15,000 in 2006 (indexed thereafter). The tax on the investment income earned by 401(k)-type plans is deferred until withdrawn.

Employees are allowed to make after-tax contributions to 401(k) and 401(k)-type plans. These contributions are not excluded from AGI, but the investment income of such after-tax contributions is not taxed when earned or withdrawn.

140. ***Individual Retirement Accounts***.—Individual taxpayers can take advantage of several different Individual Retirement Accounts (IRAs): deductible IRAs, non-deductible IRAs, and Roth IRAs. The annual contributions limit applies to the total of a taxpayer's deductible, non-deductible, and Roth IRAs contributions. The IRA contribution limit is $4,000 in 2005, and $5,000 in 2008 (indexed thereafter) and allows taxpayers over age 50 to make additional "catch-up" contributions of $1,000 (by 2006).

Taxpayers whose AGI is below $80,000 ($60,000 for non-joint filers) in 2005 can claim a deduction for IRA contributions. The IRA deduction is phased out for taxpayers with AGI between $70,000 and $80,000 ($50,000 and $60,000 for non-joint). The phase-out range increases annually until it reaches $80,000 to $100,000 in 2007. Taxpayers whose AGI is above the phase-out range can also claim a deduction for their IRA contributions depending on whether they (or their spouse) are an active participant in an employer-provided retirement plan. The tax on the investment income earned by 401(k) plans, non-deductible IRAs, and deductible IRAs is deferred until the money is withdrawn.

Taxpayers with incomes below $160,000 ($110,000 for nonjoint filers) can make contributions to Roth IRAs. The maximum contribution to a Roth IRA is phased out for taxpayers with AGI between $150,000 and $160,000 ($95,000 and $110,000 for singles). Investment income of a Roth IRA is not taxed when earned nor when withdrawn. Withdrawals from a Roth IRA are penalty free if: (1) the Roth IRA was opened at least 5 years before the withdrawal, and (2) the taxpayer either (a) is at least 591/2, (b) dies, (c) is disabled, or (d) purchases a first-time house.

Taxpayers can contribute to a non-deductible IRA regardless of their income and whether they are an active participant in an employer-provided retirement plan. The tax on investment income earned by non-deductible IRAs is deferred until the money is withdrawn.

141. ***Low and moderate income savers' credit***.—The Tax Code provides an additional incentive for lower-income taxpayers to save through a nonrefundable credit of up to 50 percent on IRA and other retirement contributions of up to $2,000. This credit is in addition to any deduction or exclusion. The credit is completely phased out by $50,000 for joint filers and $25,000 for single filers. This temporary credit is in effect from 2002 through 2006.

142. ***Keogh plans***.—Self-employed individuals can make deductible contributions to their own retirement (Keogh) plans equal to 25 percent of their income, up to a maximum of $42,000 in 2005. Total plan contributions are limited to 25 percent of a firm's total wages. The tax on the investment income earned by Keogh plans is deferred until withdrawn.

143. ***Employer-provided life insurance benefits***.—Employer-provided life insurance benefits are excluded from an employee's gross income even though the employer's costs for the insurance are a deductible business expense, but only to the extent that the employer's share of the total costs does not exceed the cost of $50,000 of such insurance.

144. ***Employer-provided accident and disability benefits***.—Employer-provided accident and disability benefits are excluded from an employee's gross income even though the employer's costs for the benefits are a deductible business expense.

145. ***Employer-provided supplementary unemployment benefits***.—Employers may establish trusts to pay supplemental unemployment benefits to employees separated from employment. Interest payments to such trusts are exempt from taxation.

146. ***Employer Stock Ownership Plan (ESOP) provisions***.—ESOPs are a special type of tax-exempt employee benefit plan. Employer-paid contributions (the value of stock issued to the ESOP) are deductible by the employer as part of employee compensation costs. They are not included in the employees' gross income for tax purposes, however, until they are paid out as benefits. The following special income tax provisions for ESOPs are intended to increase ownership of corporations by their employees: (1) annual employer contributions are subject to less restrictive limitations; (2) ESOPs may borrow to purchase employer stock, guaranteed by their agreement with the employer that the debt will be serviced by his payment (deductible by him) of a portion of wages (excludable by the employees) to service the loan; (3) employees who sell appreciated company stock to the ESOP may defer any taxes due until they withdraw benefits; and (4) dividends paid to ESOP-held stock are deductible by the employer.

147. ***Additional deduction for the blind***.—Taxpayers who are blind may take an additional $1,200 standard deduction if single, or $1,000 if married in 2005.

148. ***Additional deduction for the elderly***.—Taxpayers who are 65 years or older may take an additional $1,200 standard deduction if single, or $1,000 if married in 2005.

149. ***Tax credit for the elderly and disabled***.—Individuals who are 65 years of age or older, or who are permanently disabled, can take a tax credit equal to 15 percent of the sum of their earned and retirement income. Income is limited to no more than $5,000 for single individuals or married couples filing a joint return where only one spouse is 65 years of age or older, and up to $7,500 for joint returns where both spouses are 65 years of age or older. These limits are reduced by one-half of the taxpayer's adjusted gross income over $7,500 for single individuals and $10,000 for married couples filing a joint return.

150. ***Casualty losses***.—Neither the purchase of property nor insurance premiums to protect its value are deductible as costs of earning income; therefore, reimbursement for insured loss of such property is not reportable as a part of gross income. Taxpayers, however, may deduct uninsured casualty and theft losses of more than $100 each, but only to the extent that total losses during the year exceed 10 percent of AGI.

151. ***Earned income tax credit (EITC)***.—The EITC may be claimed by low income workers. For a family with one qualifying child, the credit is 34 percent of the first $7,830 of earned income in 2005. The credit is 40 percent of the first $11,000 of income for a family with two or more qualifying children. The credit is phased out beginning when the taxpayer's income exceeds $14,370 at the rate of 15.98 percent (21.06 percent if two or more qualifying children are present). It is completely phased out when the taxpayer's modified adjusted gross income reaches $31,030 ($35,263 if two or more qualifying children are present), $33,030 (or $37,263) for those married.

The credit may also be claimed by workers who do not have children living with them. Qualifying workers must be at least age 25 and may not be claimed as a dependent on another taxpayer's return. The credit is not available to workers age 65 or older. In 2005, the credit is 7.65 percent of the first $5,220 of earned income. When the taxpayer's income exceeds $6,530 (8,530 if married), the credit is phased out at the rate of 7.65 percent. It is completely phased out at $11,750 ($13,750 for married) of modified adjusted gross income.

For workers with or without children, the income levels at which the credit begins to phase-out and the maximum amounts of income on which the credit can be taken are adjusted for inflation. For married taxpayers filing a joint return, the base amount for the phase-out increases by $2,000 in 2005 through 2007, and $3,000 in 2008 (indexed thereafter).

Earned income tax credits in excess of tax liabilities owed through the individual income tax system are refundable to individuals. This portion of the credit is shown as an outlay, while the amount that offsets tax liabilities is shown as a tax expenditure.

152. ***Additional exemption for housing Hurricane Katrina displaced individuals***.—This provision, introduced by the Katrina Emergency Tax Relief Act of 2005, provides an additional exemption of $500 for each Hurricane Katrina displaced individual for whom the taxpayer is providing shelter in his or her home, for a maximum additional exemption amount is $2,000.

Social Security

153. ***Social Security benefits for retired workers***.—The non-taxation of Social Security benefits that exceed the beneficiary's contributions out of taxed income is a tax expenditure. These additional retirement benefits are paid for partly by employers' contributions that were not included in employees' taxable compensation. Portions (reaching as much as 85 percent) of recipients' Social Security and Tier 1 Railroad Retirement benefits are included in the income tax base, however, if the recipient's provisional income exceeds certain base amounts. Provisional income is equal to adjusted gross income plus foreign or U.S. possession income and tax-exempt interest, and one half of Social Security and tier 1 railroad retirement benefits. The tax expenditure is limited to the portion of the benefits received by taxpayers who are below the base amounts at which 85 percent of the benefits are taxable.

154. ***Social Security benefits for the disabled***.—Benefit payments from the Social Security Trust Fund for disability are partially excluded from a beneficiary's gross incomes.

155. ***Social Security benefits for dependents and survivors***.—Benefit payments from the Social Security Trust Fund for dependents and survivors are partially excluded from a beneficiary's gross income.

Veterans Benefits and Services

156. ***Veterans death benefits and disability compensation***.—All compensation due to death or disability paid by the Veterans Administration is excluded from taxable income.

157. ***Veterans pension payments***.—Pension payments made by the Veterans Administration are excluded from gross income.

158. ***G.I. Bill benefits***.—G.I. Bill benefits paid by the Veterans Administration are excluded from gross income.

159. ***Tax-exempt mortgage bonds for veterans***.—Interest earned on general obligation bonds issued by State and local governments to finance housing for veterans is excluded from taxable income. The issuance of such bonds is limited, however, to five pre-existing State programs and to amounts based upon previous volume levels for the period January 1, 1979 to June 22, 1984. Furthermore, future issues are limited to veterans who served on active duty before 1977.

General Government

160. ***Public purpose State and local bonds***.—Interest earned on State and local government bonds issued to finance public-purpose construction (e.g., schools, roads, sewers), equipment acquisition, and other public purposes is tax-exempt. Interest on bonds issued by Indian tribal governments for essential governmental purposes is also tax-exempt.

161. ***Deductibility of certain nonbusiness State and local taxes***.—Taxpayers may deduct State and local income taxes and property taxes even though these taxes primarily pay for services that, if purchased directly by taxpayers, would not be deductible.

162. ***Business income earned in U.S. possessions***.—U.S. corporations operating in a U.S. possession (e.g., Puerto Rico) can claim a credit against some or all of their U.S. tax liability on possession business income. The credit expires December 31, 2005.

Interest

163. ***U.S. savings bonds***.—Taxpayers may defer paying tax on interest earned on U.S. savings bonds until the bonds are redeemed.

Appendix:

TREASURY REVIEW OF THE TAX EXPENDITURE PRESENTATION

This appendix provides a presentation of the Treasury Department's continuing review of the tax expenditure budget. The review focuses on three issues: (1) using comprehensive income as a baseline tax system; (2) using a consumption tax as a baseline tax system; and (3) defining negative tax expenditures (provisions that cause taxpayers to pay too much tax).

The first section of this appendix compares major tax expenditures in the current budget to those implied by a comprehensive income baseline. This comparison includes a discussion of negative tax expenditures. The second section compares the major tax expenditures in the current budget to those implied by a consumption tax baseline, and also discusses negative tax expenditures. The final section addresses concerns that have been raised over the measurement of some current tax expenditures by describing new estimates of the tax expenditure caused by accelerated depreciation and by the tax exemption of the return earned on owner-occupied housing, and an alternative estimate of the tax expenditure for the preferential treatment of capital gains. The final section also provides an estimate of the negative tax expenditure caused by the double tax on corporate profits.

DIFFERENCES BETWEEN OFFICIAL TAX EXPENDITURES AND THOSE BASED ON COMPREHENSIVE INCOME

As discussed in the main body of the tax expenditure chapter, official tax expenditures are measured relative to normal law or reference law baselines that deviate from a uniform tax on a comprehensive concept of income. Consequently, tax expenditures identified in the Budget can differ from those that would be identified if a comprehensive income tax were chosen as the baseline tax system. This appendix addresses this issue by comparing major tax expenditures listed in the current tax expenditure budget with those implied by a comprehensive income baseline. Many large tax expenditures would continue to be tax expenditures were the baseline taken to be comprehensive income, although some would be smaller. A comprehensive income baseline would also result in a number of additional tax provisions being counted as tax expenditures.

Current budgetary practice excludes from the list of official tax expenditures those provisions that over-tax certain items of income. This exclusion conforms to the view that tax expenditures are substitutes for direct Government spending programs. However, this treatment gives a one-sided picture of how current law deviates from the baseline tax system. Relative to comprehensive income, a number of current tax provisions would be negative tax expenditures. Some of these also might be negative tax expenditures under the reference law or normal law baselines, expanded to admit negative tax expenditures.

Treatment of Major Tax Expenditures from the Current Budget under a Comprehensive Income Tax Baseline

Comprehensive income, also called Haig-Simons income, is the real, inflation-adjusted accretion to one's economic power arising between two points in time, e.g., the beginning and ending of the year. It includes all accretions to wealth, whether or not realized, whether or not related to a market transaction, and whether a return to capital or labor. Inflation-adjusted capital gains (and losses) would be included in comprehensive income as they accrue. Business investment and casualty losses, including losses caused by depreciation, would be deducted. Implicit returns, such as those accruing to homeowners, also would be included in comprehensive income. A comprehensive income tax baseline would tax all sources of income once. Thus, it would not include a separate tax on corporate income that leads to the double taxation of corporate profits.

While comprehensive income can be defined on the sources side of the consumer's balance sheet, it sometimes is instructive to use the identity between the sources of wealth and the uses of wealth to redefine it as the sum of consumption during the period plus the change in net worth between the beginning and the end of the period.

Comprehensive income is widely held to be the idealized base for an income tax even though it is not a perfectly defined concept.[7] It suffers from conceptual ambiguities, some of which are discussed below, as well as practical problems in measurement and tax administration, e.g., how to implement a practicable deduction for economic depreciation or include in income the return earned on consumer durable goods, including housing, automobiles, and major appliances.

Furthermore, comprehensive income does not necessarily represent an ideal tax base; efficiency or equity would be improved by deviating from comprehensive income as a tax base, e.g., by reducing the tax on capital income in order to spur economic growth further or by subsidizing certain types of activities to correct for market failures or to improve the after-tax distribution of income. In addition, some elements of comprehensive income would be difficult or impossible to include in a tax system that is administrable.

Classifying individual tax provisions relative to a comprehensive income baseline is difficult, in part because of the ambiguity of the baseline. It also is difficult because of interactions between tax provisions (or their absence). These interactions mean that it may not always be appropriate to consider each provision in isolation. Nonetheless, Appendix Table 1 attempts such a classification for each of the thirty largest tax expenditures from the Budget.

We classify fourteen of the thirty items as tax expenditures under a comprehensive tax base (those in panel A). Most of these give preferential tax treatment to the return on certain types of savings or investment. They are a result of the explicitly hybrid nature of the existing tax system and arise out of policy decisions that reflect discomfort with the high tax rate on capital income that would otherwise arise under the current

[7] See, e.g., David F. Bradford, Untangling the Income Tax (Cambridge, MA: Harvard University Press, 1986), pp. 15–31, and Richard Goode, "The Economic Definition of Income" in Joseph Pechman, ed., Comprehensive Income Taxation (Washington, D.C.: The Brookings Institution, 1977), pp. 1–29..

structure of the income tax. Even these relatively clear-cut items, however, can raise ambiguities particularly in light of the absence of integration of the corporate and individual tax systems. Given current law's corporate income tax, the reduction or elimination of individual level tax on income from investment in corporate equities might not be a tax expenditure relative to a comprehensive income baseline. Rather, an individual income tax preference might undo the corporate tax penalty (i.e., the double tax). A similar line of reasoning could be used to argue that in the case of corporations, expensing [8] of R&E or accelerated depreciation are not a tax expenditures because they serve to offset the corporate tax penalty.

Because net rental income (gross rents minus depreciation, interest, taxes, and other expenses) would be in the homeowner's tax base under a comprehensive income tax baseline, this item would be a tax expenditure relative to a comprehensive income baseline.

The exclusion of worker's compensation benefits also would be a tax expenditure under comprehensive income principles. Under comprehensive income tax principles, if the worker were to buy the insurance himself, he would be able to deduct the premium (since it represents a reduction in net worth) but should include in income the benefit when paid (since it represents an increase in net worth).[9] If the employer pays the premium, the proper treatment would allow the employer a deduction and allow the employee to disregard the premium, but he would take the proceeds, if any, into income. Current law allows the employer to deduct the premium and excludes both the premium and the benefits from the employee's tax base.

Panel B deals with items that probably are tax expenditures, but that raise issues. Current law allows deductions for home mortgage interest and for property taxes on owner-occupied housing. The tax expenditure budget includes both of these deductions. From one perspective, these two deductions would not be considered tax expenditures relative to a comprehensive tax base; a comprehensive base would allow both deductions. However, this perspective ignores current law's failure to impute gross rental income. Conditional on this failure, the deductions for interest and property taxes might be viewed as inappropriate, because they move the tax system away from rather than towards a comprehensive income tax base.[10] Indeed, the sum of the tax expenditure for these two deductions, plus the tax expenditure for the failure to include net rental income, sums to the tax expenditure for owner-occupied housing relative to a comprehensive income tax base. Consequently, there is a strong argument for classifying them as tax expenditures relative to a comprehensive income baseline.

The deduction of nonbusiness State and local taxes other than on owner-occupied homes also is included in this section. These taxes include income, sales, and property taxes. The stated justification for this tax expenditure is that "Taxpayers may deduct State and local income taxes and property taxes even though these taxes primarily pay for services that, if purchased directly by taxpayers, would not be deductible.[11] The idea is that these taxes represent (or serve as proxies for) consumption expenditures for which current law makes no imputations to income.[12] The difficulty is that this presumes that one's consumption of State and local services relates directly to the amount of State and local taxes paid. Such a presumption is difficult to sustain when taxes are levied inconsistently across taxpayers.

In contrast to the view in the official Budget, however, the deduction for State and local taxes might not be a tax expenditure if the baseline were comprehensive income. Properly measured comprehensive income would include the value of State and local government benefits received, but would allow a deduction for State and local taxes paid.[13] Thus, in this sense the deductibility of State and local taxes is consistent with comprehensive income tax principles; it should not be a tax expenditure. Nonetheless, imputing the value of State and local services is difficult and is not done under current law. Consequently, a deduction for taxes might sensibly be viewed as a (roughly measured) tax expenditure relative to a comprehensive income baseline.[14]

To the extent that the personal and dependent care exemptions and the standard deduction properly remove from taxable income all expenditures that do not yield suitably discretionary consumption value, or otherwise appropriately adjust for differing taxpaying capacity, then the child care credit and the earned income tax credit would be tax expenditures. In contrast, a competing perspective views these credits as appropriate modifications that account for differing taxpaying capacity. Even accepting this competing perspective, however, one might question why these programs come in the form of credits rather than deductions.

The step-up of basis at death lowers the income tax on capital gains for those who inherit assets below what it would be otherwise. From that perspective it would be a tax expenditure under a comprehensive income

[8] Expensing means immediate deduction. Proper income tax treatment requires capitalization followed by annual depreciation allowances reflecting the decay in value of the associated R&E spending.

[9] Suppose a taxpayer buys a one year term unemployment insurance policy at the beginning of the year. At that time he exchanges one asset, cash, for another, the insurance policy, so there is no change in net worth. But, at the end of the year, the policy expires and so is worthless, hence the taxpayer has a reduction in net worth equal to the premium. If the policy pays off during the year (i.e., the taxpayer has a work related injury), then the taxpayer would include the proceeds in income because they represent an increase in his net worth.

[10] If there were no deduction for interest and property taxes, the tax expenditure base (i.e., the proper tax base minus the actual tax base) for owner-occupied housing would equal the homeowner's net rental income: gross rents minus(depreciation+interest+property taxes+other expenses). With the deduction for interest and property taxes, the tax expenditure base rises to gross rents minus (depreciation+other expenses).

[11] Fiscal Year 2003 Budget of the United States Government, Analytical Perspectives (Washington, D.C.: U.S. Government Printing Office, 2002) p. 127.

[12] Property taxes on owner-occupied housing also might serve as a proxy for the value of untaxed local services provided to homeowners. As such, they would be listed in the tax expenditure budget (as configured, i.e., building on the estimate for the failure to tax net rents) twice, once because current law does not tax rental income and again as a proxy for government services received. Property taxes on other consumer durables such as automobiles also might be included twice, owing to current law's exclusion from income of the associated service flow.

[13] U.S. Treasury, Blueprints for Basic Tax Reform (Washington, D.C.: U.S. Government Printing Office, 1977) p. 92.

[14] Under the normal tax method employed by the Joint Committee on Taxation, the value of some public assistance benefits provided by State Governments is included as a tax expenditure, thereby raising a potential double counting issue.

baseline. Nonetheless, there are ambiguities. Under a comprehensive income baseline, all real inflation adjusted gains would be taxed as accrued, so there would be no deferred unrealized gains on assets held at death.

The lack of full taxation of Social Security benefits also is listed in panel B. Consider first Social Security retirement benefits. To the extent that Social Security is viewed as a pension, a comprehensive income tax would include in income all contributions to Social Security retirement funds (payroll taxes) and tax accretions to value as they arise (inside build-up).[15] Benefits paid out of prior contributions and the inside build-up, however, would not be included in the tax base because the fall in the value of the individual's Social Security account would be offset by an increase in cash. In contrast, to the extent that Social Security is viewed as a transfer program, all contributions should be deductible from the income tax base and all benefits received should be included in the income tax base.

A similar analysis applies to Social Security benefits paid to dependents and survivors. If these benefits represent transfers from the Government, then they should be included in the tax base. If the taxpaying unit consists of the worker plus dependents and survivors, then to the extent that Social Security benefits represent payments from a pension, the annual pension earnings should be taxed. However, benefits paid to dependents and survivors might be viewed as a gift or transfer from the decedent, in which case the dependents and survivors should pay tax on the full amount of the benefit received. (In this case the decedent or his estate should pay tax on the pension income as well, to the extent that the gift represents consumption rather than a reduction in net worth).

In addition, dependent and survivors' benefits might be viewed in part as providing life insurance. In that case, the annual premiums paid each year, or the portion of Social Security taxes attributable to the premiums, should be deducted from income, since they represent a decline in net worth, while benefits should be included in income. Alternatively, taxing premiums and excluding benefits also would represent appropriate income tax policy.

In contrast to any of these treatments, current law excludes one-half of Social Security contributions (employer-paid payroll taxes) from the base of the income tax, makes no attempt to tax accretions, and subjects some, but not all, benefits to taxation. The difference between current law's treatment of Social Security benefits and their treatment under a comprehensive income tax would qualify as a tax expenditure, but such a tax expenditure differs in concept from that included in the official Budget.

The tax expenditures in the official Budget[16] reflect exemptions for lower-income beneficiaries from the tax on 85 percent of Social Security benefits.[17] Historically, payroll taxes paid by the employee represented no more than 15 percent of the expected value of the retirement benefits received by a lower-earning Social Security beneficiary. The 85 percent inclusion rate is intended to tax upon distribution the remaining amount of the retirement benefit payment—the portion arising from the payroll tax contributions made by employers and the implicit return on the employee and employer contributions. Thus, the tax expenditure conceived and measured in the current budget is not intended to capture the deviation from a comprehensive income baseline, which would additionally account for the deferral of tax on the employer's contributions and on the rate of return (less an inflation adjustment attributable to the employee's payroll tax contributions). Rather, it is intended to approximate the taxation of private pensions with employee contributions made from after-tax income,[18] on the assumption that Social Security is comparable to such pensions. Hence, the official tax expenditure understates the tax advantage accorded Social Security retirement benefits relative to a comprehensive income baseline.

To the extent that the benefits paid to dependents and survivors should be taxed as private pensions, the same conclusion applies: the official tax expenditure understates the tax advantage.

The deduction for U.S. production activities also raises some problems. To the extent it is viewed as a tax break for certain qualifying businesses ("manufacturers"), it would be a tax expenditure. In contrast, the deduction may prove to be so broad that it is available to most U.S. businesses, in which case it might not be seen as a tax expenditure. Rather, it would represent a feature of the baseline tax rate system, because the deduction is equivalent to a lower tax rate. In addition, to the extent that it is viewed as providing relief from the double tax on corporate profits, it might not be a tax expenditure.

The next category (panel C) includes items whose treatment is less certain. The proper treatment of some of these items under a comprehensive income tax is ambiguous, while others perhaps serve as proxies for what would be a tax expenditure under a comprehensive income base.[19] Consider, for example, the items relating to charitable contributions. Under existing law, charitable contributions are deductible, and this deduction is considered on its face a tax expenditure in the current budget.[20]

The treatment of charitable donations, however, is ambiguous under a comprehensive income tax. If chari-

[15] As a practical matter, this may be impossible to do. Valuing claims subject to future contingencies is very difficult, as discussed in Bradford, Untangling the Income Tax, pp. 23–24.

[16] This includes the tax expenditure for benefits paid to workers, that for benefits paid to survivors and dependents, and that for benefits paid to dependents.

[17] The current Budget does not include as a tax expenditure the absence of income taxation on the employer's contributions (payroll taxes) to Social Security retirement at the time these contributions are made.

[18] Private pensions allow the employee to defer tax on all inside build-up. They also allow the employee to defer tax on contributions made by the employer, but not on contributions made directly by the employee. Applying these tax rules to Social Security would require the employee to include in his taxable income benefits paid out of inside build-up and out of the employer's contributions, but would allow the employee to exclude from his taxable income benefits paid out of his own contributions.

[19] See, for example, Goode, The Economic Definition of Income, pp. 16–17, and Bradford, Untangling the Income Tax, pp. 19–21, and pp.30–31.

[20] The item also includes gifts of appreciated property, at least part of which represents a tax expenditure relative to an ideal income tax, even if one assumes that charitable donations are not consumption.

table contributions are a consumption item for the giver, then they are properly included in his taxable income; a deduction for contributions would then be a tax expenditure relative to a comprehensive income tax baseline. In contrast, charitable contributions could represent a transfer of purchasing power from the giver to the receiver. As such, they would represent a reduction in the giver's net worth, not an item of consumption, and so properly would be deductible, implying that current law's treatment is not a tax expenditure. At the same time, however, the value of the charitable benefits received is income to the recipient. Under current law, such income generally is not taxed, and so represents a tax expenditure to the extent the recipient has net taxable income.[21]

Medical expenditures may or may not be an element of income (or consumption). Some argue that medical expenditures do not represent discretionary spending, and so are not really consumption. Instead, these expenditures are a reduction of net worth and should be excluded from the tax base. In contrast, others argue that there is no way to distinguish logically medical care from other consumption items. Those who view medical spending as consumption point out that there is choice in many health care decisions, e.g., whether to go to the best doctor, whether to have voluntary surgical procedures, and whether to exercise and eat nutritiously so as to improve and maintain one's health and minimize medical expenditures. This element of choice makes it more difficult to argue, at least in many cases, that medical spending is more "necessary" than, or otherwise different from, other consumption spending.

The exemption of full taxation of Social Security benefits paid to the disabled also raises some issues. Social Security benefits for the disabled most closely resemble either Government transfers or insurance. From either perspective, a comprehensive income tax would require the worker to include the benefit fully in his income and would allow him to deduct associated Social Security taxes. If viewed as insurance, an equivalent treatment would allow the taxpayer to include the premium (i.e., tax) and exclude the benefit. The deviation between either of these treatments and current law's treatment (described above) would be a tax expenditure under a comprehensive income baseline.

In contrast, as described above, the official tax expenditure measures the benefit of exemption for low-income beneficiaries from the tax on 85 percent of Social Security benefits. This measurement does not correspond closely to that required under a comprehensive income base. If the payment of the benefit is viewed as a transfer and divorced from the treatment of Social Security taxes, then the current tax expenditure understates the tax expenditure measured relative to a comprehensive income baseline. If the payment of the benefit is viewed as a transfer but the inability to deduct the employee's share of the Social Security tax is simultaneously considered, then it is less likely that the current tax expenditure overstates the tax expenditure relative to a comprehensive income baseline, and in some cases it may generate a negative tax expenditure. If the benefit is viewed as insurance and the tax as a premium, then the current tax expenditure overstates the tax expenditure relative to a comprehensive income baseline. Indeed, in the insurance model, the ability to exclude from tax only one-half of the premium might suggest that one-half of the payout should be taxed, so that the current tax rules impose a greater tax burden than that implied by a comprehensive income tax, i.e., a negative tax expenditure.

The final category (panel D) includes items that would not be tax expenditures under a comprehensive income tax base. A tax based on comprehensive income would allow all losses to be deducted. Hence, the exception from the passive loss rules would not be a tax expenditure.[22]

Major Tax Expenditures under a Comprehensive Income Tax That Are Excluded from the Current Budget

While most of the major tax expenditures in the current budget also would be tax expenditures under a comprehensive income base, there also are tax expenditures relative to a comprehensive income base that are not found on the existing tax expenditure list. These additional tax expenditures include the imputed return from certain consumer durables (e.g., automobiles), the difference between capital gains (and losses) as they accrue and capital gains as they are realized, private gifts and inheritances received, in-kind benefits from such Government programs as food-stamps, Medicaid, and public housing, the value of payouts from insurance policies,[23] and benefits received from private charities. Under some ideas of comprehensive income, the value of leisure and of household production of goods and services also would be included as tax expenditures. The personal exemption and standard deduction also might be considered tax expenditures, although they can be viewed differently, e.g., as elements of the basic tax rate schedule. The foreign tax credit also might be a tax expenditure, since a deduction for foreign taxes, rather than a credit, would seem to measure the income of U.S. residents properly.

Negative Tax Expenditures

Under current budgetary practice, negative tax expenditures, tax provisions that raise rather than lower taxes, are excluded from the official tax expenditure list. This exclusion conforms with the view that tax expenditures are intended to be similar to Government spending programs.

If attention is expanded from a focus on spending-like programs to include any deviation from the baseline tax system, negative tax expenditures would be of interest. Relative to a comprehensive income baseline, there are a number of important negative tax ex-

[21] If recipients tend to be in lower tax brackets, then the tax expenditure is smaller than when measured at the donor's tax rates..

[22] In contrast, the passive loss rules themselves, which restrict the deduction of losses, would be a negative tax expenditure when compared to a comprehensive tax base.

[23] To the extent that premiums are deductible.

penditures, some of which also might be viewed as negative tax expenditures under an expanded interpretation of the normal or reference law baseline. Among the more important negative tax expenditures is the corporation income tax, or more generally the double tax on corporate profits, which would be eliminated under a comprehensive income tax. The Jobs and Growth Tax Relief and Reconciliation Act of 2003 (JGTRRA) reduced the tax rate on dividends and capital gains to 15 percent, thus reducing the double tax compared to prior law. Nonetheless, as discussed later in the Appendix, current law still imposes a substantial double tax on corporate profits. The passive loss rules, restrictions on the deductibility of capital losses, and net operating loss (NOL) carry-forward requirements each would generate a negative tax expenditure, since a comprehensive income tax would allow full deductibility of losses. If human capital were considered an asset, then its cost (e.g., certain education and training expenses, including perhaps the cost of college and professional school) should be amortizable, but it is not under current law.[24] Some restricted deductions under the individual AMT might be negative tax expenditures as might the phase-out of personal exemptions and of itemized deductions. The inability to deduct consumer interest also might be a negative tax expenditure, as an interest deduction may be required to measure income properly, as seen by the equivalence between borrowing and reduced lending.[25] As discussed above, the current treatment of Social Security payments to the disabled also might represent a negative tax expenditure, if viewed as payments on an insurance policy.

Current tax law also fails to index for inflation interest receipts, capital gains, depreciation, and inventories. This failure leads to negative tax expenditures because comprehensive income would be indexed for inflation. Current law, however, also fails to index for inflation the deduction for interest payments; this represents a (positive) tax expenditure.

The issue of indexing also highlights that even if one wished to focus only on tax policies that are similar to spending programs, accounting for some negative tax expenditures may be required. For example, the net subsidy created by accelerated depreciation is properly measured by the difference between depreciation allowances specified under existing tax law and economic depreciation, which is indexed for inflation.[26]

DIFFERENCES BETWEEN OFFICIAL TAX EXPENDITURES AND TAX EXPENDITURES RELATIVE TO A CONSUMPTION BASE

This section compares tax expenditures listed in the official tax expenditure budget with those implied by a comprehensive consumption tax baseline. It first discusses some of the difficulties encountered in trying to compare current tax provisions to those that would be observed under a comprehensive consumption tax. Next, it discusses which of the thirty largest official tax expenditures would be tax expenditures under the consumption tax baseline, concluding that about one-half of the top thirty official tax expenditures would remain tax expenditures under a consumption tax baseline. Most of those that fall off the list are tax incentives for saving and investment.

The section next discusses some major differences between current law and a comprehensive consumption tax baseline that are excluded from the current list of tax expenditures. These differences include the consumption value of owner-occupied housing and other consumer durables, benefits from in-kind Government transfers, and gifts. It concludes with a discussion of negative tax expenditures relative to a consumption tax baseline

Ambiguities in Determining Tax Expenditures Relative to a Consumption Baseline

A broad-based consumption tax is a combination of an income tax plus a deduction for net saving. This follows from the definition of comprehensive income as consumption plus the change in net worth. It therefore seems straightforward to say that current law's deviations from a consumption base are the sum of (a) tax expenditures on an income base associated with exemptions and deductions for certain types of income, plus (b) overpayments of tax, or negative tax expenditures, to the extent net saving is not deductible from the tax base. In reality, however, the situation is more complicated. A number of issues arise, some of which also are problems in defining a comprehensive income tax, but seem more severe, or at least only more obvious, for the consumption tax baseline.

It is not always clear how to treat certain items under a consumption tax. One problem is determining whether a particular expenditure is an item of consumption. Spending on medical care and charitable donations are two examples. The classification below suggests that medical spending and charitable contributions might be included in the definition of consumption, but also considers an alternative view.

There may be more than one way to treat various items under a consumption tax. For example, a consumption tax might ignore borrowing and lending by excluding from the borrower's tax base the proceeds from loans, denying the borrower a deduction for payments of interest and principal, and excluding interest and principal payments received from the lender's tax base. On the other hand, a consumption tax might in-

[24] Current law offers favorable treatment to some education costs, thereby creating (positive) tax expenditures. Current law allows expensing of that part of the cost of education and career training that is related to foregone earnings and this would be a tax expenditure under a comprehensive income baseline.

[25] See Bradford, Untangling the Income Tax, p. 41.

[26] Accelerated depreciation can be described as the equivalent of an interest free loan from the Government to the taxpayer. Under federal budget accounting principles, such a loan would be treated as an outlay equal to the present value of the foregone interest.

clude borrowing and lending in the tax base by requiring the borrower to add the proceeds from loans in his tax base, allowing the lender to deduct loans from his tax base, allowing the borrower to deduct payments of principal and interest, and requiring the lender to include receipt of principal and interest payments. In present value terms, the two approaches are equivalent for both the borrower and the lender; in particular both allow the tax base to measure consumption and both impose a zero effective tax rate on interest income. But which approach is taken obviously has different implications (at least on an annual flow basis) for the treatment of many important items of income and expense, such as the home mortgage interest deduction. The classification below suggests that the deduction for home mortgage interest could well be a tax expenditure, but takes note of alternative views.

Some exclusions of income are equivalent in many respects to consumption tax treatment that immediately deducts the cost of an investment while taxing the future cash flow. For example, exempting investment income is equivalent to consumption tax treatment as far as the normal rate of return on new investment is concerned. This is because expensing generates a tax reduction that offsets in present value terms the tax paid on the investment's future normal returns. Expensing gives the normal income from a marginal investment a zero effective tax rate. However, a yield exemption approach differs from a consumption tax as far as the distribution of income and Government revenue is concerned. Pure profits in excess of the normal rate of return would be taxed under a consumption tax, because they are an element of cash flow, but would not be taxed under a yield exemption tax system. Should exemption of certain kinds of investment income, and certain investment tax credits, be regarded as the equivalent of consumption tax treatment? The classification that follows takes a fairly broad view of this equivalence and considers many tax provisions that reduce or eliminate the tax on capital income to be roughly consistent with a broad-based consumption tax.

Looking at provisions one at a time can be misleading. The hybrid character of the existing tax system leads to many provisions that might make good sense in the context of a consumption tax, but that generate inefficiencies because of the problem of the "uneven playing field" when evaluated within the context of the existing tax rules. It is not clear how these should be classified. For example, many saving incentives are targeted to specific tax-favored sources of capital income. The inability to save on a similar tax-favored basis irrespective of the ultimate purpose to which the saving is applied potentially distorts economic choices in ways that would not occur under a broad-based consumption tax.

In addition, provisions can interact even once an appropriate treatment is determined. For example, suppose that it is determined that financial flows should be excluded from the tax base. Then the deduction for home mortgage interest would seem to be a tax expenditure. However, this conclusion is cast into doubt because current law generally taxes interest income. When combined with the mortgage interest deduction, this results in a zero tax rate on the interest flow, consistent with consumption tax treatment.

Capital gains would not be a part of a comprehensive consumption tax base. Proceeds from asset sales and sometimes borrowing would be part of the cash-flow tax base, but, for transactions between domestic investors at a flat tax rate, would cancel out in the economy as a whole. How should existing tax expenditures related to capital gains be classified? The classification below generally views available capital gains tax breaks as consistent with a broad-based consumption tax because they lower the tax rate on capital income toward the zero rate that is consistent with a consumption-based tax.

Such considerations suggest that, as with an income tax, trying to compute the current tax's deviations from "the" base of a consumption tax is very difficult because deviations cannot be uniquely determined, making it problematic to do a consistent consistent accounting of the differences between the current tax base and a consumption tax base. Nonetheless, Appendix Table 2 attempts a classification based on the judgments outlined above.

Treatment of Major Tax Expenditures under a Comprehensive Consumption Baseline

As noted above, the major difference between a comprehensive consumption tax and a comprehensive income tax is in the treatment of saving, or in the taxation of capital income. Consequently, many current tax expenditures related to preferential taxation of capital income would not be tax expenditures under a consumption tax. However, preferential treatment of items of income that is unrelated to saving or investment incentives would remain tax expenditures under a consumption baseline. In addition, several official tax expenditures relating to items of income and expense are difficult to classify properly, while others may serve as proxies for properly measured tax expenditures.

Appendix Table 2 shows thirty large official tax expenditures from the Budget classified according to whether they would be considered a tax expenditure under a consumption tax. One of the thirty items clearly would be a tax expenditure (shown in panel A) under a consumption tax, while an additional seven (those in panel B) probably would be tax expenditures.

Exclusion of workers' compensation benefits allows an exclusion from income that is unrelated to investment, and so should be included in the base of a comprehensive consumption tax.

The deductibility of home mortgage interest is a strong candidate for inclusion as a tax expenditure. A consumption tax would seek to tax the entire value of the flow of services from housing, and so would not allow a deduction for home mortgage interest. This would be the case regardless of whether the tax base included the annual flow of housing services, or instead used a tax-prepayment or yield exemption approach (discussed more completely below) to taxing housing services. A deduction for interest would be allowed under a consumption tax applied to both real and financial cash flows, but current law does not require the homeowner to take into income the proceeds of a home loan, nor does it allow him a deduction for principle repayments.

Nonetheless, an ambiguity about the treatment if home mortgage interest arises as a result of current law's taxation of interest income. Under a consumption tax, interest income generally would not be taxed (at least in present value terms). In a sense, the homeowner's mortgage interest deduction could be viewed as counterbalancing the lender's inclusion, eliminating interest flows from the tax base, as would be appropriate under many types of consumption taxes.[27]

The deductibility of property taxes on owner-occupied housing also is a strong candidate for inclusion as a tax expenditure under a consumption tax baseline, although there is a bit of ambiguity. Property taxes would be deducted under a consumption tax under which the base allowed expensing of the cost of the house and included the rental value of the house in the annual tax base. But, as discussed above in the income tax section, this deduction nonetheless is a strong candidate for inclusion as a tax expenditure because the current tax system does not impute the consumption value of housing services to the homeowner's tax base.

Under a consumption tax that applied the yield exemption or tax prepayment approach to housing, property taxes would not be deducted by the homeowner because the cash flows (positive and negative) related to the investment are simply ignored for tax purposes—they are outside the tax base. Their deduction under current law would represent a clear case of a tax expenditure. As discussed below, current law's taxation of housing approximates a yield exemption approach; no deduction of the purchase price of the house, no tax on the house's service flow. Consequently, the deduction for property taxes probably should be a tax expenditure relative to a consumption base—there is not even the slightest ambiguity here.

With respect to the household sector's deduction of state and local income taxes, some ambiguity arises because these taxes, when considered separately from the value of any consumption type government services they might fund, should be excluded from the base of a consumption tax because they represent a reduction in net worth. Under a consumed income tax collected from the household, they would need to be deducted to properly measure consumption.

But state and local income taxes are used to fund government services, many of which would be included in the base of a consumption tax if paid for privately. The value of these services probably should be included in the base of a broad consumption tax. The value of such services is generally not imputed to the household under current tax law. One rough proxy for their value is the tax payments made to support them.[28] Stated another way, the payment of state and local income taxes might not represent a reduction in net worth (or a real net cost to the household) to the extent that the payment is accompanied by the provision of services of equal value.

The analysis of state and local sales taxes on consumption items would seem to parallel that of income taxes. When these taxes are considered in isolation from government services they might fund, they should be excluded from the base of a federal consumption tax. But to the extent sales taxes represent a user charges for government provided consumption goods, their deduction might be inappropriate because current federal tax law fails to impute to income the value of the state and local services funded by sales tax payments.

Property taxes on assets other than housing would seem to be best thought of using the model discussed above for housing. These taxes typically are paid on assets, such as automobiles and boats, that yield a stream of services that current federal tax law fails to impute to income.

The official tax expenditures for Social Security benefits reflects exceptions for low-income taxpayers from the general rule that 85 percent of Social Security benefits are included in the recipient's tax base. The 85 percent inclusion is intended as a simplified mechanism for taxing Social Security benefits as if the Social Security program were a private pension with employee contributions made from after-tax income. Under these tax rules, income earned on contributions made by both employers and employees benefits from tax deferral, but employer contributions also benefit because the employee may exclude them from his taxable income, while the employee's own contributions are included in his taxable income. These tax rules give the equivalent of consumption tax treatment, a zero effective tax rate on the return, to the extent that the original pension contributions are made by the employer, but give less generous treatment to the extent that the original contributions are made by the employee. Income earned on employee contributions is taxed at a low, but positive, effective tax rate. Based on historical calculations, the 85 percent inclusion reflects roughly the outcome of applying these tax rules to a lower-income earner when one-half of the contributions are from the employer and one-half from the employee.

The current tax expenditure measures a tax benefit relative to a baseline that is somewhere between a comprehensive income tax and a consumption tax. The properly measured tax expenditure relative to a consumption tax baseline would include only those Social Security benefits that are accorded treatment more favorable than that implied by a consumption tax, which

[27] One must guard against double counting here, however, to the extent that current law's general taxation of capital income is calculated elsewhere in the tax expenditure budget as a negative tax expenditure..

[28] The failure to impute the value of government provided services casts doubt on the appropriateness of deducting property taxes on owner-occupied housing even under a consumption tax that allowed the homeowner to deduct the cost of the house from his taxable consumption and imputed to his tax base the house's annual consumption flow. .

would correspond to including 50 percent of Social Security benefits in the recipient's tax base. Thus, the existing tax expenditure is correct conceptually, but is not measured properly relative to a comprehensive income tax. A similar analysis would apply to exclusion of Social Security benefits of dependents and retirees.

There is a strong case for viewing the child credit and the earned income tax credit as social welfare programs (transfers). As such, they would be tax expenditures relative to a consumption baseline. Nonetheless, these credits could alternatively be viewed as relieving tax on "nondiscretionary" consumption, and so not properly considered a tax expenditure.

The treatment of the items in panel C is less uncertain. Several of these items relate to the costs of medical care or to charitable contributions. As discussed in the previous section of the appendix, there is disagreement within the tax policy community over the extent to which medical care and charitable giving represent consumption items. Medical care is widely held to be consumption, except perhaps the medical care that actually raises, rather than simply sustains the individual's ability to work. Charitable giving, on the other hand, may be considered to be a reduction in net worth that should be excluded from the tax base because it does not yield direct satisfaction to taxpayer who makes the expenditure. In this case, the tax expenditure lies not with the individual making the charitable deduction, but with the exclusion from taxation of the amounts received by the recipient.

There also is the issue of how to tax medical insurance premiums. Under current law, employees do not have to include insurance premiums paid for by employers in their income. The self-employed also may exclude (via a deduction) medical insurance premiums from their taxable income. From some perspectives, these premiums should be in the tax base because they appear to represent consumption. Yet an alternative perspective would support excluding the premium from tax as long as the consumption tax base included the value of any medical services paid for by the insurance policy, because the premium equals the expected value of insurance benefits received. But even from this alternative perspective, the official tax expenditure might continue to be a tax expenditure under a consumption tax baseline because current law excludes the value of medical services paid with insurance benefits from the employee's taxable income.

If medical spending is not consumption, one approach to measuring the consumption base would ignore insurance, but allow the consumer to deduct the value of all medical services obtained. An alternative approach would allow a deduction for the premium but include the value of any insurance benefits received, while continuing to allow a deduction for a value of all medical services obtained. In either case, the official tax expenditure for the exclusion of employer-provided medical insurance and expenses would not be a tax expenditure relative to a consumption tax baseline.

Current law does not tax the annual rental value of owner-occupied housing. In contrast, the annual rental value of the housing would be taxed under a consumption tax. Hence, from one perspective, the exclusion of the net annual rental value of owner-occupied housing would be a tax expenditure relative to a consumption tax baseline.

However, a consumption tax that included in its base the annual rental value of housing also would allow the homeowner a deduction for the price of the house in the year it was purchased; the investment in housing would be expensed. Current law fails to allow such a deduction, raising doubt about classifying as a tax expenditure the exclusion of net rental income from owner-occupied housing. Indeed, it is possible to interpret current law as applying the tax pre-payment or yield exemption method to housing, in which the purchase price of an investment, rather than the annual cash flow generated by the investment, is taxed. In the textbook case, the tax pre-payment approach is equivalent in expected present value terms to taxing directly the annual consumption value of the house. So it is not clear whether the failure to tax the rental income from housing represents a tax expenditure.

The taxation of Social Security benefits for the disabled also is difficult to classify. As discussed in this appendix above, these benefits generally ought to be taxed because they represent purchasing power. However, the associated Social Security taxes ought to be fully deductible, but they are not. Hence the proper treatment is unclear. Moreover, if the insurance model is applied, the taxation of Social Security benefits might be a negative tax expenditure.

The credit for low-income housing acts to lower the tax burden on qualified investment, and so from one perspective would not be a tax expenditure under a consumption tax baseline. However, in some cases the credit is too generous; it can give a negative tax on income from qualified investment rather than the zero tax called for under consumption tax principles. In addition, the credit is very narrowly targeted. Consequently, it could be considered a tax expenditure relative to a consumption tax baseline.

The final panel (D) shows items that are not likely to be tax expenditures under a consumption base. Most of these relate to tax provisions that eliminate or reduce the tax on various types of capital income because a zero tax on capital income is consistent with consumption tax principles.

The deduction for U.S. production activities is not classified as a tax expenditure. This reflects the view that it represents a widespread reduction in taxes on capital income or an offset to the corporate income tax. In contrast to this classification, however, it would be a tax expenditure to the extent that it is viewed as a targeted tax incentive.

The exception from the passive loss rules probably would not be a tax expenditure because proper measurement of income, and hence of consumption, requires full deduction of losses.

Major Tax Expenditures under a Consumption Tax That Are Excluded from the Current Budget

Several differences between current law and a consumption tax are left off the official tax expenditure list. Additional tax expenditures possibly include benefits paid by insurance policies, in-kind benefits from such Government programs as food-stamps, Medicaid, and public housing, and benefits received from charities. Under some ideas of a comprehensive consumption tax, the value of leisure and of household production of goods and services would be included as a tax expenditure.

A consumption tax implemented as a tax on gross cash flows would tax all proceeds from sales of capital assets when consumed, rather than just capital gains; because of expensing, taxpayers effectively would have a zero basis. The proceeds from borrowing would be in the base of a consumption tax that also allowed a deduction for repayment of principal and interest, but are excluded from the current tax base. The deduction of business interest expense might be a tax expenditure, since under some forms of consumption taxation interest is neither deducted from the borrower's tax base nor included in the lender's tax base. The personal exemption and standard deduction also might be considered tax expenditures, although they can be viewed differently, e.g., as elements of the basic tax rate schedule.

Negative Tax Expenditures

Importantly, current law also deviates from a consumption tax norm in ways that increase, rather than decrease, tax liability. These could be called negative tax expenditures. The official Budget excludes negative tax expenditures on the theory that tax expenditures are intended to substitute for Government spending programs. Yet excluding negative tax expenditures gives a very one-sided look at the differences between the existing tax system and a consumption tax.

A large item on this list would be the inclusion of capital income in the current individual income tax base, including the income earned on inside-build up in Social Security accounts. The revenue from the corporate income tax, or more generally a measure of the double tax on corporate profits, also would be a negative tax expenditure. Depreciation allowances, even if accelerated, would be a negative tax expenditure since consumption tax treatment generally would require expensing. Depending on the treatment of loans, the borrower's inability to deduct payments of principal and the lender's inability to deduct loans might be a negative tax expenditure. The passive loss rules and NOL carry-forward provisions also might generate negative tax expenditures, because the change in net worth requires a deduction for losses (consumption = income—the change in net worth). If human capital were considered an asset, then its cost (e.g., certain education and training expenses, including perhaps costs of college and professional school) should be expensed, but it is not under current law. Certain restrictions under the individual AMT as well as the phase-out of personal exemptions and of itemized deductions also might be considered negative tax expenditures. Under some views, the current tax treatment of Social Security benefits paid to the disabled would be a negative tax expenditure.

REVISED ESTIMATES OF SELECTED TAX EXPENDITURES

Accelerated Depreciation

Under the reference tax law baseline no tax expenditures arise from accelerated depreciation. In the past, official tax expenditure estimates of accelerated depreciation under the normal tax law baseline compared tax allowances based on the historic cost of an asset with allowances calculated using the straight-line method over relatively long recovery periods. Normal law allowances also were determined by the historical cost of the asset and so did not adjust for inflation, although such an adjustment is required when measuring economic depreciation, the age related fall in the real value of the asset.

Beginning with the 2004 Budget, the tax expenditures for accelerated depreciation under the normal law concept have been recalculated using as a baseline depreciation rates and replacement cost indexes from the National Income and Product Accounts.[29] The revised estimates are intended to approximate the degree of acceleration provided by current law over a baseline determined by real, inflation adjusted, and economic depreciation. Current law depreciation allowances for machinery and equipment include the benefits of a temporary expensing provision.[30] The estimates are shown in tables in the body of the main text, e.g., Table 19–1.

Owner-Occupied Housing

A homeowner receives a flow of housing services equal in gross value to the rent that could have been earned had the owner chosen to rent the house to others. Comprehensive income would include in the homeowner's tax base this gross rental flow, and would allow the homeowner a deduction for expenses such as interest, depreciation, property taxes, and other costs associated with earning the rental income. Thus, a com-

[29] See Barbara Fraumeni, "The Measurement of Depreciation in the U.S. National Income and Product Accounts," in Survey of Current Business 77 No. 7 (Washington, D.C.: Department of Commerce, Bureau of Economic Analysis, July, 1997), pp. 7–42, and the National Income and Product Accounts of the United States, Table 7.6, "Chain-type Quantity and Price Indexes for Private Fixed Investment by Type," U.S. Department of Commerce, Bureau of Economic Analysis.

[30] The temporary provision allows 30 percent of the cost of a qualifying investment to be deducted immediately rather than capitalized and depreciated over time. It is generally effective for qualifying investments made after September 10, 2001 and before September 11, 2004. The Jobs and Growth Tax Relief Reconciliation Act of 2003 raised the deduction to 50 percent depreciation (up from 30 percent) of the cost new equipment purchased after May 5, 2003 and placed into service before January 1, 2005. Qualifying investments generally are limited to tangible property with depreciation recovery periods of 20 years or less, certain software, and leasehold improvements, but this set of assets corresponds closely to machinery and equipment.

prehensive tax base would include in its base the homeowner's implicit net rental income (gross income minus deductions) earned on investment in owner-occupied housing.

In contrast to a comprehensive income tax, current law makes no imputation for gross rental income and allows no deduction for depreciation or for other expenses, such as utilities and maintenance. Current law does, however, allow a deduction for home mortgage interest and for property taxes. Consequently, relative to a comprehensive income baseline, the total tax expenditure for owner-occupied housing is the sum of tax on net rental income plus the tax saving from the deduction for property taxes and for home mortgage interest.[31]

Prior to 2006, the official list of tax expenditures did not include the exclusion of net implicit rental income on owner-occupied housing. Instead, it included as tax expenditures deductions for home mortgage interest and for property taxes. While these deductions are legitimately considered tax expenditures, given current law's failure to impute rental income, they are highly flawed as estimates of the total tax advantage to housing; they overlook the additional exclusion of implicit net rental income. To the extent that a homeowner owns his house outright, unencumbered by a mortgage, he would have no home mortgage interest deduction, yet he still would enjoy the benefits of receiving tax free the implicit rental income earned on his house. The treatment of owner-occupied housing has been revised beginning in the 2006 budget, which now includes an item for the exclusion of net rental income of homeowners.[32]

Appendix Table 3, as well as the tables in the body of the main text, e.g., Tables 19–1 and 19–2, show estimates of the tax expenditure caused by the exclusion of implicit net rental income from investment in owner-occupied housing. This estimate starts with the NIPA calculated value of gross rent on owner-occupied housing, and subtracts interest, taxes, economic depreciation, and other costs in arriving at an estimate of net-rental income from owner-occupied housing.[33]

Accrued Capital Gains

Under a comprehensive income baseline, all real gains would be taxed as accrued. These gains would be taxed as ordinary income rather than at preferential rates. There would be no deferred unrealized gains on assets held at death, nor gains carried over on gifts, or other preferential treatments. Indeed, all of the provisions related to capitals gains listed in the tax expenditure budget would be dropped. Instead, in their place the difference between the ordinary tax on real gains accrued and the actual tax paid would be calculated. For 1999, for instance, the tax on real accrued gains on corporate equity is estimated at $594 billion. This compares to an estimated tax on realized gains of $62 billion, for forgone revenues of $562 billion. However, this forgone revenue may easily turn into a revenue gain given the limits on capital losses. For 2000, for instance, real accrued losses in corporate equity amounted to $1.4 trillion. Yet, taxpayers paid an estimated $70 billion in capital gains taxes. This roughly translates into an overpayment of taxes to the tune of $464 billion.

Double Tax on Corporate Profits

A comprehensive income tax would tax all sources of income once. Taxes would not vary by type or source of income.

In contrast to this benchmark, current law taxes income that shareholders earn on investment in corporate stocks at least twice, and at combined rates that generally are higher than those imposed on other sources of income. Corporate profits are taxed once at the company level under the corporation income tax. They are taxed again at the shareholder level when received as a dividend or recognized as a capital gain. Corporate profits can be taxed more then twice when they pass through multiple corporations before being distributed to noncorporate shareholders. Corporate level taxes cascade because corporations are taxed on capital gains they realize on the sale of stock shares and on some dividend income received. Compared to a comprehensive income tax, current law's double (or more) tax on corporate profits is an example of a negative tax expenditure because it subjects income to a larger tax burden than implied by a comprehensive income baseline.

Appendix Table 3 provides an estimate of the negative tax expenditure caused by the multiple levels of tax on corporate profits. This negative tax expenditure is measured as the shareholder level tax on dividends paid and capital gains realized out of earnings that have been fully taxed at the corporate level. It also includes the corporate tax paid on inter-corporate dividends and on corporate capital gains attributable to the sale of stock shares. The estimate includes the reduction in the dividends and capital gains tax rates enacted in JGTRRA.

The negative tax expenditure is large in magnitude; it exceeds $34 billion in the years 2007 through in 2011. It is comparable in size (but opposite in sign) to all but the largest official tax expenditures. JGTRRA reduced but did not eliminate the double tax on corporate profits.

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[31] The homeowner's tax base under a comprehensive income tax is net rents. Under current law, the homeowner's tax base is -(interest + property taxes). The tax expenditure base is the difference between the comprehensive income base and current law's tax base, which for homeowners is the sum of net rents plus interest plus property taxes.

[32] This estimate combines the positive tax expenditure for the failure to impute rental income with the negative tax expenditure for the failure to allow a deduction for depreciation and other costs.

[33] National Income and Production Accounts, Table 2.4.

Appendix Table 1. COMPARISON OF CURRENT TAX EXPENDITURES WITH THOSE IMPLIED BY A COMPREHENSIVE INCOME TAX [1]

Description	Revenue Effect 2007
A. Tax Expenditure Under a Comprehensive Income Tax	
Net exclusion of pension contributions and earnings: Employer plans	52,470
Accelerated depreciation of machinery and equipment (normal tax method)	52,230
Net exclusion of pension contributions and earnings: 401(k) plans	39,800
Capital gains exclusion on home sales	43,900
Exclusion of net imputed rental income on owner-occupied housing	33,210
Capital gains (except agriculture, timber, iron ore, and coal)	26,760
Exclusion of interest on public purpose State and local bonds	29,640
Exclusion of interest on life insurance savings	20,770
Net exclusion of pension contributions and earnings: Keogh plans	10,670
Expensing of research and experimentation expenditures (normal tax method)	6,990
Deferral of income from controlled foreign corporations (normal tax method)	11,940
Net exclusion of pension contributions and earnings: Individual Retirement Accounts	5,970
Exclusion of workers' compensation benefits	6,180
Credit for low-income housing investments	4,250
B. Possibly a Tax Expenditure Under a Comprehensive Income Tax, But With Some Qualifications	
Deductibility of mortgage interest on owner-occupied homes	79,860
Child credit	42,120
Step-up basis of capital gains at death	32,460
Deductibility of nonbusiness state and local taxes other than on owner-occupied homes	27,210
Exclusion of Social Security benefits for retired workers	19,590
Deductibility of State and local property tax on owner-occupied homes	12,810
Deduction for U.S. production activities	10,670
Earned income tax credit	5,150
Exclusion of Social security benefits of dependents and survivors	4,040
C. Uncertain	
Exclusion of employer contributions for medical insurance premiums and medical care	146,780
Deductibility of charitable contributions, other than education and health	34,500
Deductibility of medical expenses	5,310
Deductibility of self-employed medical insurance premiums	4,630
Social security benefits for the disabled	4,110
Deductibility of charitable contributions, education	4,030
D. Probably Not a Tax Expenditure Under a Comprehensive Income Tax	
Exception from passive loss rules for $25,000 of rental loss	6,230

[1] The measurement of certain tax expenditures under a comprehensive income tax baseline may differ from the official budget estimate even when the provision would be a tax expenditure under both baselines.Source: Table 19–2, Tax Expenditure Budget.

Appendix Table 2. COMPARISON OF CURRENT TAX EXPENDITURES WITH THOSE IMPLIED BY A COMPREHENSIVE CONSUMPTION TAX [1]

Description	Revenue Effect 2007
A. Tax Expenditure Under a Consumption Base	
Exclusion of workers' compensation benefits	6,180
B. Probably a Tax Expenditure Under a Consumption Base	
Deductibility of mortgage interest on owner-occupied homes	79,860
Child credit	42,120
Deductibility of nonbusiness state and local taxes other than on owner-occupied homes	27,210
Exclusion of Social Security benefits for retired workers	19,590
Deductibility of State and local property tax on owner-occupied homes	12,810
Earned income tax credit	5,150
Exclusion of Social Security benefits of dependents and survivors	4,040
C. Uncertain	
Exclusion of employer contributions for medical insurance premiums and medical care	146,780
Deductibility of charitable contributions, other than education and health	34,500
Exclusion of net imputed rental income on owner-occupied housing	33,210
Deductibility of medical expenses	5,310
Deductibility of self-employed medical insurance premiums	4,630
Credit for low-income housing investments	4,250
Social Security benefits for disabled	4,110
Deductibility of charitable contributions, education	3,440
D. Not a Tax Expenditure Under a Consumption Base	
Net exclusion of pension contributions and earnings: Employer plans	52,470
Accelerated depreciation of machinery and equipment (normal tax method)	52,230
Capital gains exclusion on home sales	43,900
Net exclusion of pension contributions and earnings: 401(k) plans	39,800
Step-up basis of capital gains at death	32,460
Exclusion of interest on public purpose State and local bonds	29,640
Capital gains (except agriculture, timber, iron ore, and coal)	26,760
Exclusion of interest on life insurance savings	20,770
Deferral of income from controlled foreign corporations (normal tax method)	11,940
Net exclusion of pension contributions and earnings: Keogh plans	10,670
Deduction for U.S. production activities	10,670
Expensing of research and experimentation expenditures (normal tax method)	6,990
Exception from passive loss rules for $25,000 of rental loss	6,230
Net exclusion of pension contributions and earnings: Individual Retirement Accounts	5,970

[1] The measurement of certain tax expenditures under a consumption tax baseline may differ from the official budget estimate even when the provision would be a tax expenditure under both baselines.Source: Table 19–2, Tax Expenditure Budget.

Appendix Table 3. REVISED TAX EXPENDITURE ESTIMATES [1]

Provision	Revenue Loss						
	2005	2006	2007	2008	2009	2010	2011
Imputed Rent On Owner-Occupied Housing	28,600	29,720	33,210	36,860	40,630	44,785	49,364
Double Tax on corporate profit [2]	–33,940	–33,320	–34,660	–35,900	–37,040	–38,216	–39,430

[1] Calculations described in the appendix text.
[2] This is a negative tax expenditure, a tax provision that overtaxes income relative to the treatment specified by the baseline tax system.

DIMENSIONS OF THE BUDGET

20. COMPARISON OF ACTUAL TO ESTIMATED TOTALS

In successive budgets, the Administration publishes several estimates of the surplus or deficit for a particular fiscal year. Initially, the year appears as an outyear projection at the end of the budget horizon. In each subsequent budget, the year advances in the estimating horizon until it becomes the "budget year." One year later, the year becomes the "current year" then in progress, and the following year, it becomes the just-completed "actual year."

The budget is legally required to compare budget year estimates of receipts and outlays with the subsequent actual receipts and outlays for that year. Part I of this chapter meets that requirement by comparing the actual results for 2005 with the current services estimates shown in the 2005 Budget published in February 2004.

Part II of the chapter presents a broader comparison of estimates and actual outcomes. This part first discusses the historical record of budget year estimates versus actual results over the last two decades. Second, it broadens the focus to estimates made for each year of the budget horizon, extending four years beyond the budget year. This broader focus shows that the differences between estimates and the eventual actual results grow as the estimates extend further into the future.

PART I: COMPARISON OF ACTUAL TO ESTIMATED TOTALS FOR 2005

This part of the chapter compares the actual receipts, outlays, and deficit for 2005 with the current services estimates shown in the 2005 Budget published in February 2004.[1] This part also presents a more detailed comparison for mandatory and related programs, and reconciles the actual receipts, outlays, and deficit totals shown here with the figures for 2005 previously published by the Department of the Treasury.

Receipts

Actual receipts for 2005 were $2,154 billion, $117 billion more than the $2,037 billion current services estimate in the 2005 Budget (February 2004). As shown in Table 20–1, this increase was the net effect of legislative and administrative changes; economic conditions that differed from what had been expected; and technical factors that resulted in different collection patterns and effective tax rates than had been assumed. In the interest of cautious and prudent forecasting, the February 2004 estimate included a downward adjustment beyond what the economic and receipts models were forecasting. This adjustment, which was not distributed by source of receipt, reduced the estimate of 2005 receipts by $15 billion.

Table 20–1. COMPARISON OF ACTUAL 2005 RECEIPTS WITH THE INITIAL CURRENT SERVICES ESTIMATES

(In billions of dollars)

	February 2004 estimate	Enacted legislation/ administrative actions	Different economic conditions	Technical factors	Net change	Actual
Individual income taxes	882	–16	13	48	45	927
Corporation income taxes	222	–2	–26	84	56	278
Social insurance and retirement receipts	794	....	8	–8	*	794
Excise taxes	73	2	–*	–2	–*	73
Estate and gift taxes	21	2	*	2	3	25
Customs duties	22	–*	1	–*	1	23
Miscellaneous receipts	37	*	1	–4	–4	33
Adjustment for revenue uncertainty	–15	....	....	15	15	....
Total receipts	2,037	–14	–3	134	117	2,154

* $500 million or less.

[1] The current services concept is discussed in Chapter 24, "Current Services Estimates." For mandatory programs and receipts the February 2004 current services estimate was based on laws then in place, adjusted to reflect extension of certain expiring provisions in the 2001 and 2003 tax acts. For discretionary programs the current services estimate is based on the current year estimates, excluding one-time emergency appropriations, adjusted for inflation.

Policy differences. Certain provisions in the 2001 and 2003 tax cuts were assumed to be extended in the February 2004 current services estimates. These provisions, which included tax rate reductions, marriage penalty relief, and increases in the child tax credit, reduced the current services estimate of 2005 receipts by $12 billion. These provisions were extended in the Working Families Tax Relief Act of 2004. Other legislated tax changes after February 2004 that affected 2005 receipts included the Pension Funding Equity Act and the American Jobs Creation Act of 2005. In total, these legislated tax changes reduced 2005 receipts by $26 billion, which was $14 billion more than the $12 billion in tax reductions already reflected in the current services estimates.

Economic differences. Differences between the economic assumptions upon which the current services estimates were based and actual economic performance accounted for a reduction in 2005 receipts of a net $3 billion. Higher than anticipated wages and salaries and other sources of personal income were in large part responsible for the increases in individual income taxes and social insurance and retirement receipts of $13 billion and $8 billion, respectively. These increases were more than offset by a $26 billion decrease in corporation income taxes, attributable to lower-than-expected corporate profits.

Technical reestimates. Technical factors increased 2005 receipts by a net $134 billion above the February 2004 current services estimate. This net increase was primarily attributable to higher-than-anticipated collections of individual and corporation income taxes of $48 billion and $84 billion, respectively. Different collection patterns and effective tax rates than assumed in February 2004 were primarily responsible for the higher-than-anticipated collections of individual and corporation income taxes. Higher-than-anticipated collections of estate and gift taxes increased 2005 receipts an additional $2 billion above the February 2004 estimate. Lower-than-anticipated collections of other sources of receipts of nearly $15 billion were in large part captured by the adjustment for revenue uncertainty, resulting in no net effect on receipts, relative to the February 2004 estimate.

Outlays

Outlays for 2005 were $2,472 billion, $75 billion more than the $2,397 billion current services estimate in the 2005 Budget (February 2004).

Table 20–2 distributes the $75 billion net increase in outlays among discretionary and mandatory programs and net interest.[2] The table also makes rough estimates according to three reasons for the changes: policy; economic conditions; and technical estimating differences, a residual.

Policy changes are the result of legislative actions that change spending levels, primarily through higher or lower appropriations or changes in authorizing legislation, which may themselves reflect responses to changed economic conditions. For 2005, policy changes increased outlays by an estimated $57 billion relative to the initial current services estimates.

Policy changes increased discretionary outlays by $50 billion. Defense discretionary outlays increased by $39 billion and nondefense discretionary outlays increased by $10 billion. A significant portion of both defense and nondefense outlay increases resulted from enactment of the Emergency Hurricane Supplemental Appropriations Acts in 2004 and the Emergency Supplemental Appropriations Act for Defense, the Global War on Terror, and Tsunami Relief in 2005. Policy changes increased mandatory outlays by $6 billion above current law. Drought and other aid to farmers enacted in one of the Emergency Hurricane Supplemental Appropria-

[2] Discretionary programs are controlled by annual appropriations, while mandatory programs are generally controlled by authorizing legislation. Mandatory programs are mostly formula benefit or entitlement programs with permanent spending authority that depend on eligibility criteria, benefit levels, and other factors.

Table 20–2. COMPARISON OF ACTUAL 2005 OUTLAYS WITH THE INITIAL CURRENT SERVICES ESTIMATES

(Outlays in billions)

	Current Services (Feb. 2004)	Changes				Actual
		Policy	Economic	Technical	Total changes	
Discretionary:						
Defense	439	39	....	15	55	494
Nondefense	471	10	....	–6	4	475
Subtotal, discretionary	910	50	....	9	59	968
Mandatory:						
Social Security	510	–*	5	3	8	519
Other programs	799	6	–*	–3	2	801
Subtotal, mandatory	1,309	6	5	–*	11	1,320
Net interest	178	1	3	2	6	184
Total outlays	2,397	57	8	11	75	2,472

* $500 million or less.

Table 20–3. COMPARISON OF THE ACTUAL 2005 DEFICIT WITH THE INITIAL CURRENT SERVICES ESTIMATE

(In billions)

	Current Services (Feb. 2004)	Changes				Actual
		Policy	Economic	Technical	Total changes	
Receipts	2,037	–14	–3	134	117	2,154
Outlays	2,397	57	8	11	75	2,472
Deficit	360	71	11	–123	–42	318

Note: Deficit changes are outlays minus receipts. For these changes, a plus indicates fan increase in the deficit.

tions Acts in 2004, increased agricultural outlays by $3 billion. In addition, child tax credit outlays increased by $2 billion due to enactment of the Working Families Tax Relief Act of 2004. The remaining $1 billion increase largely consists of tobacco payments and higher outlays for other mandatory programs, partially offset by the extension of expiring Customs user fees and a delay in obligations by the Crime Victims Fund. Debt service costs increased by $1 billion due to outlay and revenue policy changes.

Economic conditions that differed from those forecast in February 2004 resulted in a net increase in outlays of $8 billion. The most significant changes consist of a $5 billion increase in Social Security benefits largely resulting from higher cost-of-living adjustments and a $3 billion increase in net interest due to higher-than-expected interest rates.

Technical estimating differences and other changes resulted in a net increase in outlays of $11 billion. Technical changes result from changes in such factors as the number of beneficiaries for entitlement programs, crop conditions, or other factors not associated with policy changes or economic conditions. Outlays for discretionary programs increased an estimated $9 billion because budget authority for defense programs was spent faster than expected, partially offset by slower-than-expected outlays for nondefense programs. The technical outlay change for mandatory programs netted to a decrease of less than $500 million. Higher-than-anticipated outlays for higher-education programs, Medicare, and other mandatory programs were slightly more than offset by lower-than-anticipated outlays for unemployment compensation and other programs. Net interest outlays increased by $2 billion due to technical factors compared to the February 2004 estimates.

Deficit

The preceding two sections discussed the differences between the initial current services estimates and the actual amounts of Federal Government receipts and outlays for 2005. This section combines these effects to show the net impact of these differences.

As shown in Table 20–3, the 2005 current services deficit was initially estimated to be $360 billion. The actual deficit was $318 billion, which was a $42 billion decrease from the initial estimate. Receipts were $117 billion more than the initial estimate and outlays were $75 billion more. The table shows the distribution of the changes according to the categories in the preceding two sections.

The net effect of policy changes for receipts and outlays increased the deficit by $71 billion. Economic conditions that differed from the initial assumptions in February 2004 accounted for an estimated $11 billion increase in the deficit. Technical factors reduced the deficit by an estimated $123 billion.

Comparison of the Actual and Estimated Outlays Outlays for Mandatory and Related Programs Programs for 2005

This section compares the original 2005 outlay estimates for mandatory and related programs under current law in the 2005 Budget (February 2004) with the actual outlays. Major examples of these programs include Social Security and Medicare benefits for the elderly, agricultural price support payments to farmers, and deposit insurance for banks and thrift institutions. This category also includes net interest outlays and undistributed offsetting receipts.

A number of factors may cause differences between the amounts estimated in the budget and the actual mandatory outlays. For example, legislation may change benefit rates or coverage; the actual number of beneficiaries may differ from the number estimated; or economic conditions (such as inflation or interest rates) may differ from what was assumed in making the original estimates.

Table 20–4 shows the differences between the actual outlays for these programs in 2005 and the amounts originally estimated in the 2005 Budget, based on laws in effect at that time. Actual outlays for mandatory spending and net interest in 2005 were $1,504 billion, which was $17 billion more than the initial estimate of $1,487 billion, based on existing law in February 2004.

As table 20–4 shows, actual outlays for mandatory human resources programs were $1,363 billion, $16 billion more than originally estimated. This increase was the net effect of legislative action, differences between actual and assumed economic conditions, differences between the anticipated and actual number of beneficiaries, and other technical differences. Outlays for other functions were $3 billion less than originally estimated. Undistributed offsetting receipts were $3 billion higher than expected, thus reducing total outlays.

Table 20–4. COMPARISON OF ACTUAL AND ESTIMATED OUTLAYS FOR MANDATORY AND RELATED PROGRAMS UNDER CURRENT LAW

(In billions of dollars)

	2005		
	Feb. 2005 estimate	Actual	Change
Mandatory outlays:			
Human resources programs:			
Education, training, employment, and social services	11	18	8
Health:			
Medicaid	183	182	–1
Other	19	18	–*
Total health	202	200	–2
Medicare	290	294	5
Income security:			
Retirement and disability	99	100	1
Unemployment compensation	41	32	–8
Food and nutrition assistance	43	45	2
Other	112	114	2
Total, income security	295	292	–3
Social security	510	519	8
Veterans benefits and services:			
Income security for veterans	37	36	–1
Other	2	4	1
Total veterans benefits and services	39	40	1
Total mandatory human resources programs	1,347	1,363	16
Other functions:			
Agriculture	17	21	4
International	–2	–4	–2
Deposit insurance	–2	–1	*
Other functions	12	7	–5
Total, other functions	25	22	–3
Undistributed offsetting receipts:			
Employer share, employee retirement	–57	–59	–2
Rents and royalties on the outer continental shelf	–5	–6	–1
Other undistributed offsetting receipts	–*	–*	–*
Total undistributed offsetting receipts	–62	–65	–3
Total, mandatory	1,309	1,320	11
Net interest:			
Interest on Treasury debt securities (gross)	350	352	2
Interest received by trust funds	–161	–161	–*
Other interest	–11	–7	4
Total net interest	178	184	6
Total outlays for mandatory and net interest	1,487	1,504	17

* $500 million or less.

Outlays for net interest were $184 billion, or $6 billion more than the original estimate. This increase was the net effect of changes in interest rates from those initially assumed, changes in borrowing requirements due to differences in surpluses, and technical factors.

Reconciliation of Differences with Amounts Published by Treasury for 2005

Table 20–5 provides a reconciliation of the receipts, outlays, and deficit totals published by the Department of the Treasury in the September 2005 Monthly Treasury Statement and those published in this Budget. The Department of the Treasury made adjustments to the estimates for the Combined Statement of Receipts, Outlays, and Balances, which decreased receipts and outlays by $977 million and $1,125 million, respectively. Most of this adjustment was the correction of reporting for the unemployment insurance program. Additional adjustments for this Budget increased receipts by $531 million and outlays by $409 million. Several financial

Table 20–5. RECONCILIATION OF FINAL AMOUNTS FOR 2005

(In millions of dollars)

	Receipts	Outlays	Deficit
Totals published by Treasury (September 30 MTS)	2,154,305	2,472,920	–318,615
Miscellaneous Treasury adjustments	–977	–1,125	148
Totals published by Treasury in Combined Statement	2,153,328	2,471,796	–318,468
Affordable Housing Program	232	198	34
Exchange Stabilization Fund	....	–169	169
Public Company Accounting Oversight Board	130	130	....
National Railroad Retirement Investment Trust	....	70	–70
United Mine Workers of America benefit funds	125	125	....
Other	44	55	–11
Total adjustments, net	531	409	122
Totals in the budget	2,153,859	2,472,205	–318,346
MEMORANDUM:			
Total change since year-end statement	–446	–715	269

transactions that are not reported to the Department of the Treasury, including those for the Affordable Housing Program, the Public Company Accounting Oversight Board, and the United Mine Workers of America benefit funds, are included in the budget. Other significant conceptual differences in reporting are for the National Railroad Retirement Investment Trust (NRRIT) and the Exchange Stabilization Fund. Reporting to the Department of the Treasury for the NRRIT is done with a one month lag so that the fiscal year total provided in the Treasury Combined Statement covers September 2004 through August 2005. The budget has been adjusted to reflect transactions that occurred during the actual fiscal year, which begins in October. For the Exchange Stabilization Fund, reporting for the budget excludes the gains and losses in the valuation of foreign currencies held in the fund.

Part II: HISTORICAL COMPARISON OF ACTUAL TO ESTIMATED SURPLUSES OR DEFICITS

This part of the chapter compares estimated surpluses or deficits to actual outcomes over the last two decades. The first section compares the estimate for the budget year of each budget with the subsequent actual result. The second section extends the comparison to the estimated surpluses or deficits for each year of the budget window: that is, for the current year through the fourth year following the budget year. This part concludes with some observations on the historical record of estimates of the surplus or deficit versus the subsequent actual outcomes.

Historical Comparison of Actual to Estimated Results for the Budget Year

Table 20–6 compares the estimated and actual surpluses or deficits since the deficit estimated for 1982 in the 1982 Budget. The estimated surpluses or deficits for each budget include the Administration's policy proposals. Therefore, the original deficit estimate for 2005 differs from that shown in Table 20–3, which is on a current services basis. Earlier comparisons of actual and estimated surpluses or deficits were on a policy basis, so for consistency the figures in Table 20–6 are on this basis.

On average, the estimates for the budget year underestimated actual deficits (or overestimated actual surpluses) by $27 billion over the 24-year period. Policy outcomes that differed from the original proposals increased the deficit by an average of $30 billion. Differences between economic assumptions and actual economic performance increased the deficit an average of $12 billion. Differences due to these two factors were partly offset by technical revisions, which reduced the deficit an average of $15 billion.

The relatively small average difference between actual and estimated deficits conceals a wide variation in the differences from budget to budget. The differences ranged from a $389 billion underestimate of the deficit to a $190 billion overestimate. The $389 billion underestimate, in the 2002 Budget, was due largely to receipt shortfalls related to the 2001 recession and associated weak stock market performance. About a quarter of the underestimate was due to increased spending for recovery from the September 11, 2001 terrorist attacks, homeland security measures, and the war against terror, along with lower receipts due to tax relief in the March 2002 economic stimulus act. The $190 billion overestimate of the deficit in the 1998 Budget stemmed largely from stronger-than-expected economic growth and a surge in individual income tax collections beyond that accounted for by economic factors.

Because the average deficit difference obscures the degree of under- and overestimation in the historical data, a more appropriate statistic to measure the magnitude of the differences is the average absolute difference. This statistic measures the difference without regard to whether it was an under- or overestimate.

Table 20–6. COMPARISON OF ESTIMATED AND ACTUAL SURPLUSES OR DEFICITS SINCE 1982

(In billions of dollars)

Budget	Surplus or deficit (–) estimated for budget year [1]	Differences due to			Total difference	Actual surplus or deficit(–)
		Enacted legislation	Economic factors	Technical factors		
1982	–62	15	–70	–11	–66	–128
1983	–107	–12	–67	–22	–101	–208
1984	–203	–21	38	–0	17	–185
1985	–195	–12	–17	12	–17	–212
1986	–180	–8	–27	–7	–41	–221
1987	–144	2	–16	8	–6	–150
1988	–111	–9	–19	–16	–44	–155
1989	–130	–22	10	–11	–23	–153
1990	–91	–21	–31	–79	–131	–221
1991	–63	21	–85	–143	–206	–269
1992	–281	–36	–21	48	–9	–290
1993	–350	–8	–13	115	95	–255
1994	–264	–8	16	52	61	–203
1995	–165	–18	1	18	1	–164
1996	–197	6	53	30	89	–107
1997	–140	1	–4	121	118	–22
1998	–121	–9	48	151	190	69
1999	10	–22	56	82	116	126
2000	117	–42	88	73	119	236
2001	184	–129	32	41	–56	128
2002	231	–104	–201	–84	–389	–158
2003	–80	–86	–34	–177	–297	–378
2004	–307	–122	–22	39	–105	–412
2005	–364	–67	–11	123	45	–318
Average		–30	–12	15	–27	
Absolute average [2]		33	41	61	98	
Standard deviation		42	58	80	134	

[1] Surplus or deficit estimate includes the effect of the budget's policy proposals.

[2] Absolute average is the average without regard to sign.

Since 1982, the average absolute difference has been $98 billion.

Another measure of variability is the standard deviation. This statistic measures the dispersion of the data around the average value. The standard deviation of the deficit differences since 1982 is $134 billion. Like the average absolute difference, this measure illustrates the high degree of variation in the difference between estimates and actual deficits.

The large variability in errors in estimates of the surplus or deficit for the budget year underscores the inherent uncertainties in estimating the future path of the Federal budget. Some estimating errors are unavoidable, because of differences between the President's original budget proposals and the legislation that Congress subsequently enacts. Occasionally such differences are huge, such as additional appropriations for disaster recovery, homeland security, and war efforts in response to the terrorist attacks of September 11, 2001, which were obviously not envisioned in the President's Budget submitted the previous February. Even aside from differences in policy outcomes, errors in budget estimates can arise from new economic developments, unexpected changes in program costs, shifts in taxpayer behavior, and other factors. The budget impact of changes in economic assumptions is discussed further in Chapter 12 of this volume, "Economic Assumptions."

Five-Year Comparison of Actual to Estimated Surpluses or Deficits

The substantial differences between actual surpluses or deficits and the budget year estimates made less than two years earlier raises questions about the degree of variability for estimates of years beyond the budget year. Table 20–7 shows the summary statistics for the differences for the current year (CY), budget year (BY), and the four succeeding years (BY+1 through BY+4). These are the years that are required to be estimated in the budget by the Budget Enforcement Act of 1990.

On average, the budget estimates since 1982 overstated the deficit in the current year by $20 billion, but underestimated the deficit in the budget year by $27 billion. The budget estimates understated the deficit in the years following, by amounts growing from $63 billion for BY+1 to $121 billion for BY+4. While these results suggest a tendency to underestimate deficits toward the end of the budget horizon, the averages are not statistically different from zero in light of the high variation in the data.

The average absolute difference between estimated and actual deficits grows dramatically over the six years from CY through BY+4, from $53 billion in the current year to $98 billion for the budget year, to $255 billion for BY+4. While under- and overestimates of the deficit have historically tended to average out, the

Table 20–7. DIFFERENCES BETWEEN ESTIMATED AND ACTUAL SURPLUSES OR DEFICITS FOR FIVE-YEAR BUDGET ESTIMATES SINCE 1982

(In billions of dollars)

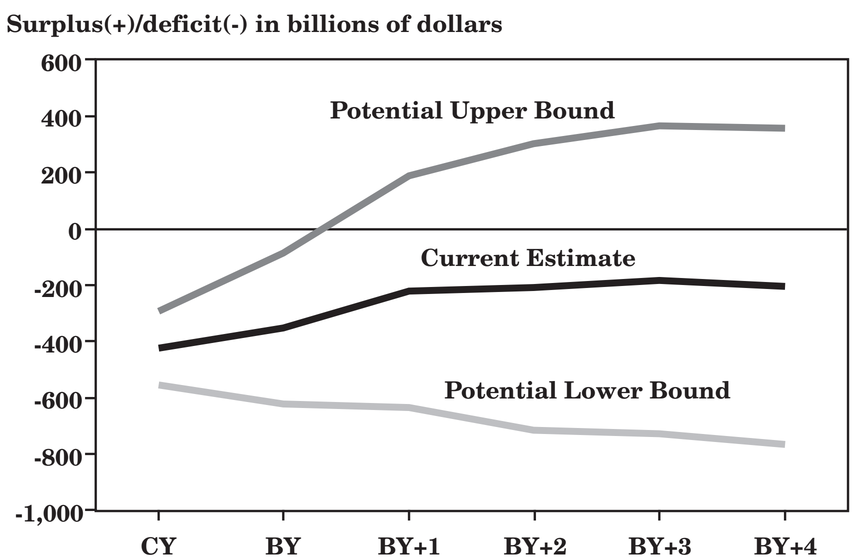
	Current year estimate	Budget year estimate	Estimate for budget year plus			
			One year (BY+1)	Two years (BY+2)	Three years (BY+3)	Four years (BY+4)
Average difference [1]	20	–27	–63	–99	–118	–121
Average absolute difference [2]	53	98	153	210	240	255
Standard deviation	65	134	206	254	273	281

[1] A positive figure represents an underestimate of the surplus or an overestimate of the deficit.
[2] Average absolute difference is the difference without regard to sign.

absolute size of the under- or overestimates grows as the estimates extend further into the future. The standard deviation of the deficit differences shows the same pattern. The standard deviation grows from $65 billion for current year estimates to $134 billion for the budget year estimates and continues to increase steadily as the estimates extend further out, reaching $281 billion for BY+4.

The estimates of variability in the difference between estimated and actual deficits can be used to construct a range of uncertainty around a given set of estimates. Statistically, if these differences are normally distributed, the actual deficit will be within a range of two standard deviations above or below the estimate about 90 percent of the time. Chart 20–1 shows this range of two standard deviations applied to the deficit estimates in this Budget. This chart illustrates that unforeseen economic developments, policy outcomes, or other factors could give rise to large swings in the deficit estimates.

Chart 20-1. Illustrative Range of Budget Outcomes



21. OUTLAYS TO THE PUBLIC, GROSS AND NET

Table 21–1 shows outlays gross and net of offsetting collections and offsetting receipts from the public for all major agencies.

The following table shows outlays gross of offsetting collections and offsetting receipts from the public. Since outlays are an important measure of Government spending, the table demonstrates that offsetting receipts and offsetting collections from the public are relatively more important for some agencies than for others when discussing net outlays.

See the section on "outlays" in Chapter 26, "The Budget System and Concepts," for a more detailed discussion on the outlay totals in the budget.

In this table, negative net outlays occur when offsetting collections exceed payments. The amounts for "Allowances" cover certain transactions that are expected to increase or decrease outlays but are not, for various reasons, attributed to any specific agency. The amounts labeled "undistributed offsetting receipts" are deducted from the Government-wide outlay totals but not from any specific agency.

Offsetting collections and offsetting receipts are discussed in more detail in Chapter 18 of this volume, "User Charges and Other Collections."

Table 21–1. TOTAL OUTLAYS, GROSS AND NET OF OFFSETTING COLLECTIONS AND RECEIPTS FROM THE PUBLIC, BY AGENCY, 2005–2007

(In millions of dollars)

Department or Other Unit	2005			2006			2007		
	Outlays Gross of Collections and Receipts from the Public	Offsetting Collections and Receipts from the Public	Net Outlays	Outlays Gross of Collections and Receipts from the Public	Offsetting Collections and Receipts from the Public	Net Outlays	Outlays Gross of Collections and Receipts from the Public	Offsetting Collections and Receipts from the Public	Net Outlays
Legislative Branch	4,067	–67	4,000	4,487	–60	4,427	4,500	–62	4,438
Judicial Branch	5,612	–46	5,566	6,136	–48	6,088	6,437	–51	6,386
Executive Branch									
Department of Agriculture	106,839	–21,555	85,284	118,660	–22,948	95,712	112,441	–19,658	92,783
Department of Commerce	8,448	–2,280	6,168	8,403	–1,941	6,462	8,591	–1,988	6,603
Department of Defense—Military	486,917	–12,483	474,434	523,312	–11,233	512,079	516,738	–11,875	504,863
Department of Education	74,237	–1,292	72,945	85,393	–1,409	83,984	66,751	–2,267	64,484
Department of Energy	27,100	–5,753	21,347	28,323	–6,620	21,703	27,972	–6,553	21,419
Department of Health and Human Services	625,507	–43,980	581,527	697,830	–56,366	641,464	765,056	–65,476	699,580
Department of Homeland Security	47,835	–8,533	39,302	76,201	–9,448	66,753	55,124	–11,571	43,553
Department of Housing and Urban Development	44,999	–2,481	42,518	48,994	–2,187	46,807	47,120	–2,452	44,668
Department of the Interior	15,463	–6,362	9,101	16,745	–7,633	9,112	17,090	–7,658	9,432
Department of Justice	23,492	–769	22,723	23,129	–835	22,294	25,680	–998	24,682
Department of Labor	49,542	–2,577	46,965	55,485	–4,051	51,434	58,783	–5,426	53,357
Department of State	14,437	–1,620	12,817	14,753	–1,133	13,620	15,877	–1,390	14,487
Department of Transportation	57,379	–448	56,931	61,775	–522	61,253	65,918	–267	65,651
Department of the Treasury	425,593	–16,851	408,742	471,476	–19,351	452,125	513,928	–19,635	494,293
Department of Veterans Affairs	75,097	–5,102	69,995	76,844	–6,434	70,410	79,048	–5,204	73,844
Corps of Engineers-Civil Works	6,648	–1,882	4,766	8,425	–1,012	7,413	6,934	–1,055	5,879
Other Defense Civil Programs	43,502	–19	43,483	45,685	–17	45,668	47,318	–19	47,299
Environmental Protection Agency	8,285	–365	7,920	8,296	–366	7,930	8,320	–416	7,904
Executive Office of the President	7,723	....	7,723	7,362	....	7,362	2,391	....	2,391
General Services Administration	681	–626	55	1,047	–640	407	1,517	–619	898
International Assistance Programs	27,878	–12,924	14,954	28,751	–12,449	16,302	28,825	–11,982	16,843
National Aeronautics and Space Administration	12,458	3,155	15,613	15,772	–218	15,554	16,579	–223	16,356
National Science Foundation	5,435	....	5,435	5,760	....	5,760	5,838	....	5,838
Office of Personnel Management	69,809	–10,298	59,511	74,512	–11,053	63,459	79,186	–11,921	67,265
Small Business Administration	3,133	–631	2,502	2,261	–1,073	1,188	661	–56	605
Social Security Administration	568,998	–7,672	561,326	599,975	–7,525	592,450	630,673	–7,964	622,709
Export-Import Bank of the United States	700	–1,513	–813	345	–2,166	–1,821	251	–205	46
Federal Deposit Insurance Corporation	–165	–707	–872	472	–1,378	–906	65	–1,430	–1,365
Postal Service	67,281	–68,504	–1,223	72,702	–71,176	1,526	74,993	–71,491	3,502
Railroad Retirement Board	5,646	–3,454	2,192	6,149	–895	5,254	6,336	–1,367	4,969
Other Independent Agencies	28,145	–12,664	15,481	26,259	–13,008	13,251	26,818	–12,344	14,474
Allowances	....	....	....	3,726	....	3,726	5,464	....	5,464

Table 21–1. TOTAL OUTLAYS, GROSS AND NET OF OFFSETTING COLLECTIONS AND RECEIPTS FROM THE PUBLIC, BY AGENCY, 2005–2007—Continued

(In millions of dollars)

Department or Other Unit	2005			2006			2007		
	Outlays Gross of Collections and Receipts from the Public	Offsetting Collections and Receipts from the Public	Net Outlays	Outlays Gross of Collections and Receipts from the Public	Offsetting Collections and Receipts from the Public	Net Outlays	Outlays Gross of Collections and Receipts from the Public	Offsetting Collections and Receipts from the Public	Net Outlays
Undistributed Offsetting Receipts	–219,907	–6,306	–226,213	–232,345	–9,228	–241,573	–246,242	–29,261	–275,503
Totals:	2,728,814	–256,609	2,472,205	2,993,100	–284,423	2,708,677	3,082,981	–312,884	2,770,097

22. TRUST FUNDS AND FEDERAL FUNDS

The budget consists of two major groups of funds: Federal funds and trust funds. This section presents summary information about the transactions of each of these two fund groups. Information is provided about the income and outgo of the major trust funds and a number of Federal funds that are financed by earmarked collections in a manner similar to trust funds.

Federal Funds Group

The Federal funds group comprises the larger part of the budget. It includes all transactions not classified by law as being in trust funds.

The main financing component of the Federal funds group is the general fund, which is used to carry out the general purposes of Government rather than being restricted by law to a specific program. It consists of all collections not earmarked by law to finance other funds, including virtually all income taxes and many excise taxes, and all expenditures financed by these collections and by Treasury borrowing.

The Federal funds group also includes special funds and revolving funds, which earmark collections for spending on specific purposes. Where the law requires that Federal fund collections from a specified source be earmarked to finance a particular program, such as a portion of the Outer Continental Shelf mineral leasing receipts deposited into the Land and Water Conservation Fund, the collections and associated disbursements are recorded in special fund receipt and expenditure accounts. The majority of special fund collections are derived from the Government's power to impose taxes, fines, and other compulsory payments. They must be appropriated before they can be obligated and spent. However, significant amounts of collections credited to special funds are derived from business-like activity, such as the receipts from Outer Continental Shelf mineral leasing.

Revolving funds conduct continuing cycles of business-like activity. They charge for the sale of products or services and use the proceeds to finance their spending. Instead of being deposited in receipt accounts, their

Table 22–1. RECEIPTS, OUTLAYS, AND SURPLUS OR DEFICIT BY FUND GROUP

(In billions of dollars)

	2005 Actual	Estimate					
		2006	2007	2008	2009	2010	2011
Receipts:							
Federal funds cash income:							
From the public	1,355.5	1,445.6	1,546.7	1,673.1	1,729.3	1,833.6	1,930.2
From trust funds	3.3	2.1	5.3	3.1	3.2	3.2	3.3
Total, Federal funds cash income	1,358.8	1,447.7	1,552.0	1,676.2	1,732.5	1,836.8	1,933.5
Trust funds cash income:							
From the public	903.2	962.6	1,016.6	1,071.6	1,125.9	1,187.6	1,253.4
From Federal funds:							
Interest	162.7	171.1	183.3	197.2	213.8	229.9	244.9
Other	238.9	294.8	333.1	347.0	359.4	375.3	402.2
Total, trust funds cash income	1,304.8	1,428.5	1,533.0	1,615.8	1,699.1	1,792.9	1,900.4
Offsetting receipts	–509.8	–590.7	–669.2	–701.7	–717.4	–751.5	–799.1
Total, unified budget receipts	2,153.9	2,285.5	2,415.9	2,590.3	2,714.2	2,878.2	3,034.9
Outlays:							
Federal funds cash outgo	1,913.9	2,136.5	2,172.4	2,193.9	2,249.4	2,324.0	2,424.0
Trust funds cash outgo	1,068.0	1,162.9	1,266.8	1,321.4	1,389.7	1,488.4	1,614.9
Offsetting receipts	–509.8	–590.7	–669.2	–701.7	–717.4	–751.5	–799.1
Total, unified budget outlays	2,472.2	2,708.7	2,770.1	2,813.6	2,921.8	3,060.9	3,239.8
Surplus or deficit (–):							
Federal funds	–555.1	–688.8	–620.4	–517.7	–516.9	–487.2	–490.5
Trust funds	236.7	265.6	266.2	294.4	309.4	304.5	285.6
Total, unified surplus/deficit (–)	–318.3	–423.2	–354.2	–223.3	–207.6	–182.7	–204.9

Note: Receipts include governmental, interfund, and proprietary receipts. They exclude intrafund receipts, which are offset against intrafund payments so that cash income and cash outgo of the fund group are not overstated.

proceeds are recorded in the revolving funds, which are expenditure accounts. These collections generally are available automatically for obligation and making payments. Outlays for revolving funds are reported net of offsetting collections. There are two classes of revolving funds. Public enterprise funds, such as the Postal Service Fund, conduct business-like operations mainly with the public. Intragovernmental funds, such as the Federal Buildings Fund, conduct business-like operations mainly within and between Government agencies.

Trust Funds Group

The trust funds group consists of funds that are designated by law as trust funds. Like special funds and revolving funds, they earmark collections for spending on specific purposes. Many of the larger trust funds finance social insurance payments for individuals, such as Social Security, Medicare, and unemployment compensation. Other major trust funds finance military and Federal civilian employees' retirement benefits, highway and transit construction, and airport and airway development. There are a few trust revolving funds that are credited with collections earmarked by law to carry out a cycle of business-type operations. Trust funds also include a few small funds established to carry out the terms of a conditional gift or bequest.

There is no substantive difference between trust funds and special funds or between revolving funds and trust revolving funds. Whether a particular fund is designated in law as a trust fund is, in many cases, arbitrary. For example, the National Service Life Insurance Fund is a trust fund, but the Servicemen's Group Life Insurance Fund is a Federal fund, even though both are financed by earmarked fees paid by veterans and both provide life insurance payments to veterans' beneficiaries. [1]

The Federal budget meaning of the term "trust" differs significantly from the private sector usage. The beneficiary of a private trust owns the trust's income and often its assets. A custodian manages the assets on behalf of the beneficiary according to the stipulations of the trust, which he or she cannot change unilaterally. In contrast, the Federal Government owns the assets and earnings of most Federal trust funds, and it can unilaterally raise or lower future trust fund collections and payments, or change the purpose for which the collections are used, by changing existing law. Only a few small Federal trust funds are managed pursuant to a trust agreement where the Government is the trustee, and the Government generally owns them and has some ability to determine the amount deposited into or paid out of these funds. Other amounts are held in deposit funds by the Government as a custodian on behalf of some entity outside the Government. The Government makes no decisions about the amount of these deposits or how they are spent. Therefore, these funds are considered to be non-budgetary instead of Federal trust funds and are excluded from the Federal budget.

A trust fund must use its income for the purposes designated by law. Some, such as the Federal Employees Health Benefits fund, spend their income almost as quickly as it is collected. Others, such as the Social Security and the Federal civilian employees retirement trust funds, currently spend considerably less than they collect each year. A surplus of income over outgo adds to the trust fund's balance, which is available to finance future expenditures. The balances are generally invested, by law, in Treasury securities. [2]

A trust fund normally consists of one or more receipt accounts (to record income) and an expenditure account (to record outgo). However, a few trust funds, such as the Veterans Special Life Insurance fund, are established by law as revolving funds. These funds are similar to revolving funds in the Federal funds group, in that they may consist of a single account to record both income and outgo. They conduct a cycle of business-type operations; offsetting collections are credited to the funds (which are expenditure accounts); and their outlays are displayed net of the offsetting collections.

Income and Outgo by Fund Group

Table 22–1 shows income, outgo, and surplus or deficit by fund group and adds them together (and removes double-counting) to derive the total unified budget receipts, outlays, and surplus or deficit. The estimates assume enactment of the President's budget proposals. Income consists mostly of receipts (derived from governmental activity—primarily income, payroll, and excise taxes—and gifts). It also consists of offsetting receipts, which include proprietary receipts (derived from business-like transactions with the public) and interfund collections (receipts by one fund of payments from a fund in the other fund group) that are deposited in receipt accounts. Outgo consists of payments made to the public or to a fund in the other fund group.

Two types of transactions are treated specially in the table. First, income and outgo for a fund group exclude transactions between funds within the same fund group. [3] These intrafund transactions constitute outgo and income for the individual funds that make and collect the payments. However, because the totals for each fund group measure its transactions with the public and the other fund group, intrafund transactions must be subtracted from the sum of the income and outgo of all individual funds within the fund group to calculate the consolidated income and outgo for that fund group as a whole. Second, income excludes the

[1] Another example is the Violent Crime Reduction Trust Fund, established pursuant to the Violent Crime Control and Law Enforcement Act of 1994. Because the Fund is substantively a means of accounting for general fund appropriations, and does not have any dedicated receipts, it is classified as a Federal fund rather than a trust fund, notwithstanding the presence of the words "Trust Fund" in its official name.

[2] The relationships between Treasury securities held by trust funds (and by other Government accounts), debt held the public, and gross Federal debt are discussed in Chapter 16 of this volume, "Federal Borrowing and Debt."

[3] For example, the railroad retirement trust funds pay the equivalent of social security benefits to railroad retirees, in addition to the regular railroad pension. These benefits are financed by a payment from the Federal Old-Age and Survivors Insurance trust fund to the railroad retirement trust funds. The payment and collection are both deducted so that total trust fund income and outgo measure disbursements to the public and to Federal funds.

Table 22–2. INCOME, OUTGO, AND BALANCES OF TRUST FUNDS GROUP

(In billions of dollars)

	2005 Actual	Estimate					
		2006	2007	2008	2009	2010	2011
Total Trust Funds							
Balance, start of year	2,911.9	3,148.5	3,414.2	3,680.4	3,974.7	4,284.1	4,588.6
Income:							
Governmental receipts	846.8	895.5	940.0	989.7	1,039.9	1,098.3	1,159.4
Proprietary receipts	68.7	80.1	90.4	96.7	101.6	106.0	111.8
Receipts from Federal funds:							
Interest	162.7	171.1	183.3	197.2	213.8	229.9	244.9
Other	272.7	330.9	371.3	387.1	401.6	419.8	449.7
Receipts adjustments	....	–*	....	....	....	....	....
Subtotal, income	1,350.9	1,477.5	1,585.0	1,670.7	1,757.0	1,854.1	1,965.7
Outgo:							
To the public	1,110.8	1,209.8	1,313.5	1,373.2	1,444.4	1,546.3	1,676.8
Payments to Federal funds	3.3	2.1	5.3	3.1	3.2	3.2	3.3
Subtotal, outgo	1,114.1	1,211.9	1,318.8	1,376.3	1,447.6	1,549.5	1,680.1
Change in fund balance:							
Surplus or deficit (–):							
Excluding interest	74.1	94.5	82.9	97.2	95.5	74.6	40.7
Interest	162.7	171.1	183.3	197.2	213.8	229.9	244.9
Subtotal, surplus or deficit (–)	236.7	265.6	266.2	294.4	309.4	304.5	285.6
Adjustments:							
Transfers/lapses (net)	–0.1	–*	–*	....	....	....	....
Other adjustments	*	*	*	....	....	....	....
Total, change in fund balance	236.6	265.6	266.2	294.4	309.4	304.5	285.6
Balance, end of year	3,148.5	3,414.2	3,680.4	3,974.7	4,284.1	4,588.6	4,874.2

* $50 million or less.

offsetting collections, which are offset against outgo in revolving fund expenditure accounts instead of being deposited in receipt accounts.[4] It would be conceptually appropriate to classify these collections as income, but at present the data are not tabulated centrally for both fund groups. Consequently, they are offset against outgo in Table 22–1 and are not shown separately.

Some funds in the Federal funds group and some trust funds are authorized to borrow from the general fund of the Treasury.[5] Borrowed funds are not recorded as receipts of the fund or included in the income of the fund. The borrowed funds finance outlays by the fund in excess of available receipts. Subsequently, fund receipts are transferred from the fund to the general fund in repayment of the borrowing. The repayment is not recorded as an outlay of the fund or included in fund outgo.

Some income in both Federal funds and trust funds consists of offsetting receipts. In contrast, for most budget purposes, offsetting receipts are excluded from receipts figures and subtracted from gross outlays. There are two reasons for the normal treatment:

- *Business-like or market-oriented activities with the public:* The collections from such activities are deducted from gross outlays, rather than added to receipts, in order to produce budget totals for receipts and outlays that represent governmental rather than market activity.
- *Intragovernmental transactions:* Collections by one Government account from another are deducted from gross outlays, rather than added to receipts, so that the budget totals measure the transactions of the Government with the public.

Because the income for Federal funds and for trust funds recorded in Table 22–1 includes offsetting receipts, those offsetting receipts must be deducted from the two fund groups' combined gross income in order to reconcile to total (net) unified budget receipts. Similarly, because the outgo for Federal funds and for trust funds in Table 22–1 consists of outlays gross of offsetting receipts, the amount of the offsetting receipts must be deducted from the sum of the Federal funds' and the trust funds' gross outgo in order to reconcile to total (net) unified budget outlays. Table 22–3 reconciles, for fiscal year 2005, the gross total of all trust fund and Federal fund receipts with the net total of the

[4] For example, postage stamp fees are deposited as offsetting collections in the Postal Service fund. As a result, the Fund's outgo is disbursements net of collections.

[5] For example, the Bonneville Power Administration Fund, a revolving fund in the Department of Energy, is authorized to borrow from the general fund, and the Black Lung Disability Trust Fund in the Department of Labor is authorized to receive appropriations of repayable advances from the general fund (a form of borrowing).

Federal fund group's and the trust fund group's cash income (as shown in Table 22–1), and with the unified budget's receipt total.

Income, Outgo, and Balances of Trust Funds

Table 22–2 shows, for the trust funds group as a whole, the funds' balance at the start of each year, income and outgo during the year, and the end of year balance. Income and outgo are divided between transactions with the public and transactions with Federal funds. Receipts from Federal funds are divided between interest and other interfund receipts.

The definition of income and outgo in this table differs from those in Table 22–1 in one important way. Trust fund collections that are offset against outgo (as offsetting collections) within expenditure accounts instead of being deposited in separate receipt accounts are classified as income in this table but not in Table 22–1. This classification is consistent with the definitions of income and outgo for trust funds used elsewhere in the budget. It has the effect of increasing both income and outgo by the amount of the offsetting collections. The difference was approximately $46 billion in 2005. Table 22–2, therefore, provides a more complete summary of trust fund income and outgo.

The trust funds group is expected to have large and growing surpluses over the projection period. As a consequence, trust fund balances are estimated to grow substantially, as they have over the past two decades. The size of the anticipated balances is unprecedented, and it results mainly from relatively recent changes in the way some trust funds are financed.

Primarily because of these changes, but also because of the impact of real growth and inflation, trust fund balances increased tenfold from 1982 to 2000, from $205 billion to $2.1 trillion. The balances are estimated to more than double again by the year 2011, rising to $4.9 trillion.[6] Almost all of these balances are invested in Treasury securities and earn interest. Therefore, they represent the value, in current dollars, of taxes and user fees that have been paid in advance for future benefits and services.

Until the 1980s, most trust funds operated on a pay-as-you-go basis. Taxes and user fees were set at levels high enough to finance program expenditures and administrative expenses, and to maintain prudent reserves, generally defined as being equal to one year's expenditures. As a result, trust fund balances tended to grow at about the same rate as their annual expenditures.

Pay-as-you-go financing was replaced in the 1980s by full or partial advance funding for some of the larger

[6] The trust fund balances shown here reflect the Administration's proposal to add Personal Retirement Accounts (PRAs) as part of a reform to return the social security program to solvency. Because the PRAs would be privately owned, their balances would not be included in the budget or in trust fund balances. Diverting a portion of payroll taxes into PRAs will slow the growth of aggregate trust fund balances in the short term, but this effect will ultimately be offset by lower social security benefit payments to those who opt for PRAs, and thus have a neutral effect on the growth of fund balances in the long run.

Table 22–3. RELATIONSHIP OF TOTAL FEDERAL FUND AND TRUST FUND RECEIPTS TO UNIFIED BUDGET RECEIPTS, FISCAL YEAR 2005

(In billions of dollars)

Gross trust fund receipts	1,309.5
Gross Federal fund receipts	1,392.1
Total of trust fund receipts and Federal fund receipts	2,701.6
Deduct intrafund receipts (from funds within the same fund group):	
Trust intrafund receipts	–4.7
Federal intrafund receipts	–33.3
Subtotal, intrafund receipts	–38.0
Total of trust funds cash income and Federal funds cash income	2,663.6
Deduct offsetting receipts: [1]	
Trust fund receipts from Federal funds:	
Interest in receipt accounts	–161.0
General fund payment to Medicare Parts B and D	–115.2
Employing agencies' payments for pensions, Social Security, and Medicare	–48.4
General fund payments for unfunded liabilities of Federal employees retirement funds	–47.2
Transfer of taxation of Social Security and RRB benefits to OASDI, HI, and RRB	–26.3
Other receipts from Federal funds	–3.4
Subtotal, trust fund receipts from Federal funds	–401.6
Federal fund receipts from trust funds	–3.3
Proprietary receipts	–104.9
Subtotal, offsetting receipts	–509.8
Unified budget receipts	2,153.9

[1] Offsetting receipts are included in cash income for each fund group, but in the unified budget totals are excluded from the receipts total and instead deducted from outlays.

trust funds. In order to partially prefund the social security benefits of the "baby-boomers", the Social Security Amendments of 1983 raised payroll taxes above the levels necessary to finance current expenditures. In 1984 a new system was set up to finance military retirement benefits on a full accrual basis. In 1986 full accrual funding of retirement benefits was mandated for Federal civilian employees hired after December 31, 1983. The latter two changes require Federal agencies and their employees to make annual payments to the Federal employees' retirement trust funds in an amount equal to the retirement benefits earned by employees. Since many years will pass between the time when benefits are earned and when they are paid, the trust funds will accumulate substantial balances over time.

These balances are available to finance future benefit payments and other trust fund expenditures—but only in a bookkeeping sense. These funds are not set up to be pension funds, like the funds of private pension plans. The holdings of the trust funds are not assets of the Government as a whole that can be drawn down in the future to fund benefits. Instead, they are claims on the Treasury. When trust fund holdings are redeemed to pay benefits, Treasury will have to finance the expenditure in the same way as any other Federal expenditure: out of current receipts, by borrowing from the public, or by reducing benefits or other expenditures. The existence of large trust fund balances, therefore, does not, by itself, increase the Government's ability to pay benefits.

From an economic standpoint, the Government is able to prefund benefits only by increasing saving and investment in the economy as a whole. This can be fully accomplished only by simultaneously running trust fund surpluses equal to the actuarial present value of the accumulating benefits and not allowing the Federal fund deficit to increase, so that the trust fund surplus reduces a unified budget deficit or increases a unified budget surplus. This would reduce Federal borrowing by the amount of the trust funds surplus and increase the amount of national saving available to finance investment. Greater investment would increase future incomes and wealth, which would provide more real economic resources to support the benefits.

Table 22–4, on the CD-ROM included with this volume, shows estimates of income, outgo, and balances for 2004 through 2011 for the major trust funds. With the exception of transactions between trust funds, the data for the individual trust funds are conceptually the same as the data in Table 22–2 for the trust funds group. As explained previously, transactions between trust funds are shown as outgo of the fund that makes the payment and as income of the fund that collects it in the data for an individual trust fund, but the collections are offset against outgo in the data for the trust fund group. Additional information for these and other trust funds can be found in the Status of Funds tables in the Budget Appendix.

Table 22–5 (also on the CD-ROM) shows income, outgo, and balances of four existing Federal funds—three revolving funds and one special fund. It also shows a recently-established special fund of the same general type: a fund for military retirees' health benefits. All these funds are similar to trust funds in that they are financed by earmarked receipts, the excess of income over outgo is invested, the interest earnings add to balances, and the balances remain available to finance future expenditures. The table is illustrative of the Federal funds group, which includes many other revolving funds and special funds in addition to the ones shown.

23. OFF–BUDGET FEDERAL ENTITIES AND NON–BUDGETARY ACTIVITIES

The unified budget of the Federal Government is divided by law between on-budget and off-budget entities. Despite this legal distinction, the off-budget Federal entities engage in the same basic activities of government as the on-budget entities. They conduct similar programs and the programs they conduct result in the same kind of spending and receipts as do the on-budget entities. Off-budget spending channels economic resources toward particular uses in the same way as does on-budget spending. Off-budget spending and receipts are discussed further in the following section on off-budget Federal entities.

The budget is a financial plan for proposing, deciding, and controlling the allocation of resources by the Federal Government. It does not include, however, the financial consequences of all Federal activities. Some of these activities are non-budgetary by their inherent nature either because the activities are not conducted by agencies of the Government, such as the financial intermediation provided by Government-sponsored enterprises; or because the funds involved are privately owned, such as the deposit funds owned by Indian tribes and managed on their behalf by the Government in a fiduciary capacity. In other cases, such as regulation, the Federal activities give rise to costs that are borne by the private sector rather than the Government. Although non-budgetary, some of these activities are important instruments of Federal policy and are discussed in other parts of the budget along with relevant financial data. They are also discussed further in the section of this chapter on non-budgetary activities.

TABLE 23–1. COMPARISON OF TOTAL, ON-BUDGET, AND OFF-BUDGET TRANSACTIONS [1]

(In billions of dollars)

Fiscal Year	Receipts			Outlays			Surplus or deficit (–)		
	Total	On-budget	Off-budget	Total	On-budget	Off-budget	Total	On-budget	Off-budget
1980	517.1	403.9	113.2	590.9	477.0	113.9	–73.8	–73.1	–0.7
1981	599.3	469.1	130.2	678.2	543.0	135.3	–79.0	–73.9	–5.1
1982	617.8	474.3	143.5	745.7	594.9	150.9	–128.0	–120.6	–7.4
1983	600.6	453.2	147.3	808.4	660.9	147.4	–207.8	–207.7	–0.1
1984	666.5	500.4	166.1	851.9	685.7	166.2	–185.4	–185.3	–0.1
1985	734.1	547.9	186.2	946.4	769.4	176.9	–212.3	–221.5	9.2
1986	769.2	569.0	200.2	990.4	806.9	183.5	–221.2	–237.9	16.7
1987	854.4	641.0	213.4	1,004.1	809.3	194.8	–149.7	–168.4	18.6
1988	909.3	667.8	241.5	1,064.5	860.1	204.4	–155.2	–192.3	37.1
1989	991.2	727.5	263.7	1,143.8	932.9	210.9	–152.6	–205.4	52.8
1990	1,032.1	750.4	281.7	1,253.1	1,028.1	225.1	–221.0	–277.6	56.6
1991	1,055.1	761.2	293.9	1,324.3	1,082.6	241.7	–269.2	–321.4	52.2
1992	1,091.3	788.9	302.4	1,381.6	1,129.3	252.3	–290.3	–340.4	50.1
1993	1,154.5	842.5	311.9	1,409.5	1,142.9	266.6	–255.1	–300.4	45.3
1994	1,258.7	923.7	335.0	1,461.9	1,182.5	279.4	–203.2	–258.8	55.7
1995	1,351.9	1,000.9	351.1	1,515.9	1,227.2	288.7	–164.0	–226.4	62.4
1996	1,453.2	1,085.7	367.5	1,560.6	1,259.7	300.9	–107.4	–174.0	66.6
1997	1,579.4	1,187.4	392.0	1,601.3	1,290.7	310.6	–21.9	–103.2	81.4
1998	1,722.0	1,306.2	415.8	1,652.7	1,336.1	316.6	69.3	–29.9	99.2
1999	1,827.6	1,383.2	444.5	1,702.0	1,381.3	320.8	125.6	1.9	123.7
2000	2,025.5	1,544.9	480.6	1,789.2	1,458.5	330.8	236.2	86.4	149.8
2001	1,991.4	1,483.9	507.5	1,863.2	1,516.4	346.8	128.2	–32.4	160.7
2002	1,853.4	1,338.1	515.3	2,011.2	1,655.5	355.7	–157.8	–317.4	159.7
2003	1,782.5	1,258.7	523.8	2,160.1	1,797.1	363.0	–377.6	–538.4	160.8
2004	1,880.3	1,345.5	534.7	2,293.0	1,913.5	379.5	–412.7	–568.0	155.2
2005	2,153.9	1,576.4	577.5	2,472.2	2,070.0	402.2	–318.3	–493.6	175.3
2006 estimate	2,285.5	1,675.5	610.0	2,708.7	2,277.7	431.0	–423.2	–602.1	179.0
2007 estimate	2,415.9	1,773.5	642.3	2,770.1	2,317.0	453.1	–354.2	–543.4	189.2
2008 estimate	2,590.3	1,911.1	679.1	2,813.6	2,347.1	466.5	–223.3	–436.0	212.7
2009 estimate	2,714.2	1,998.0	716.2	2,921.8	2,435.2	486.6	–207.6	–437.2	229.7
2010 estimate	2,878.2	2,119.7	758.5	3,060.9	2,527.2	533.7	–182.7	–407.5	224.8
2011 estimate	3,034.9	2,233.3	801.6	3,239.8	2,648.7	591.1	–204.9	–415.4	210.5

[1] Off-budget transactions consist of the Social Security trust funds and the Postal Service fund.

Off-Budget Federal Entities

The Federal Government has used the unified budget concept as the foundation for its budgetary analysis and presentation since the 1969 Budget. This concept was developed by the President's Commission on Budget Concepts in 1967. It calls for the budget to include all the Federal Government's programs and all the fiscal transactions of these programs with the public.

Every year since 1971, however, at least one Federal entity has been declared to be off-budget. Off-budget Federal entities are federally owned and controlled, but their transactions are excluded from the on-budget totals by law. When a Federal entity is off-budget, its receipts, outlays, and surplus or deficit are separated from the on-budget receipts, outlays, and surplus or deficit; and its budget authority is also separated from the total budget authority for the on-budget Federal entities. The Budget Enforcement Act of 1990 excluded off-budget entities from its general enforcement provisions (except for the administrative expenses of Social Security); it had separate enforcement provisions for Social Security.

Off-budget Federal entities conduct programs of the same type as on-budget entities. Most of the tables in the budget include both on-budget and off-budget amounts both separately and in combination, or show them only as a total amount, in order to show the unified budget totals that measure Federal outlays and receipts comprehensively.

The off-budget Federal entities currently consist of the two Social Security trust funds, old-age and survivors insurance and disability insurance, and the Postal Service fund. Social Security was classified off-budget as of 1986 and the Postal Service fund in 1989. A number of other entities were declared off-budget at different times before 1986, but have been classified on-budget by law at least since 1985.

Table 23–1 divides total Federal Government receipts, outlays, and the surplus or deficit between on-budget and off-budget amounts. Within this table the Social Security and Postal Service transactions are classified as off-budget for all years, in order to provide a consistent comparison over time. Entities that were off-budget at one time but are now on-budget are classified as on-budget for all years.

The off-budget entities are a significant part of total Federal spending and receipts. In 2007, off-budget receipts are an estimated 27 percent of total receipts, and off-budget outlays are a smaller, but still significant, percentage of total outlays at 16 percent. The estimated unified budget deficit in 2007 is $354 billion—a $543 billion on-budget deficit partly offset by a $189 billion off-budget surplus. The off-budget surplus consists almost entirely of the Social Security surplus. Social Security had small deficits or surpluses from its inception through the early 1980s, but since the middle 1980s it has had a large and growing surplus. However, under present law, the surplus is eventually estimated to decline, turn into a deficit, and never reach balance again. The long-term challenge of Social Security is addressed in a chapter of the main budget volume, "The Nation's Fiscal Outlook," and in Chapter 13 of this volume, "Stewardship."

Non-Budgetary Activities

Federal credit: budgetary and non-budgetary transactions.—The Federal Credit Reform Act of 1990 refined budget concepts by distinguishing between the costs of credit programs, which are budgetary in nature, and the other transactions of credit programs, which are not. For 1992 and subsequent years, the costs of direct loans and loan guarantees are calculated as the present value of estimated cash outflows from the Government less the present value of estimated cash inflows to the Government. These costs are similar to the net outlays of other Federal programs and are included in the budget as outlays of credit program accounts whenever the Federal Government makes a direct loan or guarantees a private loan.

All of the other cash transactions with the public that result from Government credit programs—the disbursement and repayment of loans, the payment of default claims on guarantees, the collection of interest and fees, and so forth—are recorded in separate financing accounts. The financing accounts also receive payments from the credit program accounts for the costs of direct loans and loan guarantees. The net transactions of the financing accounts—i.e., the cash transactions with the public less the amounts received from the program accounts—are not costs to the Government. Therefore, the net transactions of the financing accounts are non-budgetary in concept, and the Act excludes them from the budget.[1] Because they are non-budgetary in concept, they are not classified as off-budget Federal entities. Transactions in the financing accounts do, however, affect the Government's borrowing requirement, as explained in Chapter 16 of this volume, "Federal Borrowing and Debt."

The budget outlays of credit programs thus measure the cost of Government credit decisions, and they record this cost when the credit assistance is provided. This enables the budget to more effectively fulfill its purpose of being a financial plan for allocating resources among alternative uses: comparing the cost of a program with its benefits, comparing the cost of credit programs with the cost of other spending programs, and comparing the cost of one type of credit assistance with the cost of another type.[2]

Credit programs are discussed in Chapter 7 of this volume, "Credit and Insurance."

Deposit funds.—Deposit funds are non-budgetary accounts that record amounts held by the Government

[1] See §505(b) of the Federal Credit Reform Act of 1990.

[2] For more explanation of the budget concepts for direct loans and loan guarantees, see the sections on Federal credit and credit financing accounts in Chapter 26 of this volume, "The Budget System and Concepts." The structure of credit reform is further explained in Chapter VIII.A of the *Budget of the United States Government, Fiscal Year 1992*, Part Two, pp. 223–26. The implementation of credit reform through 1995 is reviewed in Chapter 8, "Underwriting Federal Credit and Insurance," *Analytical Perspectives, Budget of the United States Government, Fiscal Year 1997*, pp. 142–44. Refinements and simplifications enacted by the Balanced Budget Act of 1997 or provided by later OMB guidance are explained in Chapter 8, "Underwriting Federal Credit and Insurance," *Analytical Perspectives, Budget of the United States Government, Fiscal Year 1999*, p. 170.

temporarily until ownership is determined (such as earnest money paid by bidders for mineral leases) or held by the Government as an agent for others (such as State income taxes withheld from Federal employees' salaries and not yet paid to the States). The largest deposit fund is the Thrift Savings Fund, which holds stocks and bonds as an agent for Federal employees who participate in the Thrift Savings Plan, a defined contribution retirement plan. Because these assets are the property of the employees and are held by the Government in a fiduciary capacity, the transactions of the fund are not transactions of the Government itself and therefore are non-budgetary in concept. The administrative costs and the transactions of budgetary accounts with the fund are included in the budget. For similar reasons, the budget excludes funds that are owned by Indian tribes and held and managed by the Government in a fiduciary capacity on the tribes' behalf. The Social Security personal retirement accounts proposed by the Administration would be owned by individuals, not the Government. Contributions into the accounts will be recorded as outlays, but the accounts themselves will be non-budgetary in nature. If these accounts were held by the Government, it would be only in a fiduciary capacity, and the accounts would be classified as deposit funds. Deposit funds are further discussed in a section of Chapter 26 of this volume, "The Budget System and Concepts."

Taxation and tax expenditures.—Taxation provides the Government with income, which is included in the budget as "receipts." Taxes withdraw purchasing power from the private sector to finance Government expenditures. In addition to this primary economic effect, taxation has important effects on the incentives that affect the allocation of resources among private uses and the distribution of income among individuals. These effects depend on the structure of the Federal tax system, the tax rates and other structural characteristics of each Federal tax. The effects of taxation on resource allocation and income distribution can be similar to the effects of outlays, but these effects are treated as non-budgetary.

One of the ways that the tax system affects resource allocation and income distribution is through special exclusions, exemptions, deductions, and similar provisions that have been added to the tax code over time, and which can be identified by comparing the tax law with an idealized tax baseline. The revenue discrepancies caused by these special provisions are defined as "tax expenditures" and are discussed in Chapter 19 of this volume, "Tax Expenditures." That chapter includes tables with estimates for tax expenditures associated with the individual and corporation income taxes. The chapter also compares tax expenditures with spending programs and regulation as alternative methods for achieving policy objectives, and it provides an illustrative overview of performance measures that might be used to evaluate tax expenditures.

The baseline concepts used to identify and measure tax expenditures in Chapter 19 reflect important ambiguities. Although partly patterned on a comprehensive income tax, they are subjective, as explained in the tax expenditure chapter in recent years, and are open to question in a number of respects. The appendix to Chapter 19 provides the Treasury Department's preliminary review of the current tax expenditure presentation, focusing on three issues: (1) using a comprehensive income tax as a baseline, (2) using a comprehensive consumption tax as a baseline, and (3) defining negative tax expenditures (i.e., provisions that cause people to pay more tax than they would under a baseline—such as the failure to adjust interest, capital gains, and depreciation for inflation in comparison to a comprehensive income tax).

Government-sponsored enterprises.—The Federal Government has established several Government-sponsored enterprises, such as Fannie Mae, Freddie Mac, and the Farm Credit Banks, to provide financial intermediation for specified public purposes. They are excluded from the budget because they are privately owned and controlled. However, primarily because they were established by the Federal Government originally for public-policy purposes, and because they still serve such purposes to some extent, estimates of their activities are reported in a separate chapter of the budget Appendix, and their activities are analyzed in Chapter 7 of this volume, "Credit and Insurance."

Regulation.—Some types of regulation, by requiring the private sector to make expenditures for specified purposes, such as safety and pollution control, have economic effects that are similar to budget outlays or tax expenditures. Regulatory priorities and plans are described in the annual *Regulatory Plan* and the semi-annual *Unified Agenda of Federal Regulatory and Deregulatory Actions*.[3]

The Office of Management and Budget began to publish an annual report on the costs and benefits of Federal regulation in 1997. The latest report, *Validating Regulatory Analysis*, was released in December 2005 and also includes a report on unfunded mandates.[4] The report estimates the total costs and benefits of major Federal regulations reviewed by OMB from October 1994 through September 2005 and the impact of Federal regulation on State, local, and tribal governments. It also reviews the international literature on the effects of regulation on national economic growth and performance, reviews the accuracy of projected benefit and cost estimates by comparing the projected impacts of a subset of Federal regulation with benefit and cost information obtained after the regulations have been implemented, and summarizes the Administration's regulatory reform accomplishments. The draft of the 2006 report will be published in February 2006 for public comment.

[3] The most recent publication was issued by the General Services Administration's Regulatory Information Service Center in October 2005 and printed in the *Federal Register* of October 31, 2005 (vol. 70, no. 209), and is available on-line at www.reginfo.gov.

[4] Office of Information and Regulatory Affairs, Office of Management and Budget, *Validating Regulatory Analysis: 2005 Report to Congress on the Costs and Benefits of Federal Regulations and Unfunded Mandates on State, Local, and Tribal Entities* (2005).

24. FEDERAL EMPLOYMENT AND COMPENSATION

This section provides information on civilian and military employment in the Executive, Legislative, and Judicial branches. It also provides information on personnel compensation and benefits and on overseas staffing presence.

Measuring Federal Employment

For budgetary purposes, civilian employment is measured on the basis of full-time equivalents (FTEs). One FTE is equal to one work year (see OMB Circular A–11, Section 32). Put simply, one full-time employee counts as one FTE, and two half-time employees also count as one FTE.

Significant Changes in Civilian Employment

Table 24–1 shows Executive Branch civilian FTE (excluding the U.S. Postal Service) growing by two percent between 2003 and 2007. The primary reason for this growth is related to homeland security and the global war on terrorism. Significant changes by agency are discussed below.

The *Department of Commerce* requests additional FTE, the majority of which will allow the U.S. Patent and Trademark Office (PTO) to reduce a large backlog of patent applications. PTO fees fully fund the increase in FTE. The augmentation is also due to increased workload associated with the 2010 Census development and testing, including full implementation of the American Community Survey, by the Census Bureau.

The *Department of Energy* is increasing its FTE as it continues to oversee the Nation's effort to improve energy supply and conservation. Increases are also due to weapons-related workload within the National Nuclear Security Administration.

The *Department of Health and Human Services* is requesting additional FTE to support the implementation of the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (MMA) at the Centers for Medicare and Medicaid Services; conduct hearings and appeals as directed by the MMA, expand staff at the Indian Health Service health care facilities; increase scientific research positions at the National Institutes of Health; conduct pre-market review of new drugs, medical devices, animal drugs, and other products regulated at the Food and Drug Administration (FDA) and the FDA Office of Drug Safety; increase activities at the Office of the National Coordinator for Health Information Technology; implement pandemic influenza preparedness and biodefense activities; increase Inspector General's work on fraud and abuse in a number of HHS programs, including Medicaid; and add Program Support Center staff to handle increased Service and Supply Fund business.

The total FTE for the *Department of Homeland Security* continues to stabilize. New increases are driven by additional personnel for immigration, customs, and border protection.

Department of Justice FTE are increasing due to enhancements in law enforcement and homeland security-related programs. This growth largely occurs in the Federal Bureau of Investigation, Federal Prison System, Bureau of Alcohol, Tobacco, Firearms, and Explosives, and the U.S. Marshals.

The majority of the FTE increase for the *Department of Veterans Affairs* is related to VA Medical Care in order to provide timely, accessible, and high quality care to our Nation's veterans. The remaining increase is primarily to ensure timely and accurate benefits processing.

The *Office of Personnel Management* gains FTE as it completes the transfer of security investigative personnel from the Department of Defense to OPM.

The *Social Security Administration* is projecting a decrease in FTE as the agency completes its increased workload related to processing applications for prescription drugs under the Medicare Prescription Drug Improvement and Modernization Act of 2003.

Significant Changes in Military Employment

As seen in Table 24–3, the *Department of Defense's* request reduces active duty personnel. The bulk of these positions are being eliminated in the Navy and Air Force as part of those Services' streamlining and rightsizing efforts. The remaining personnel were extra strength on active duty due to Global War on Terror requirements.

Personnel Compensation and Benefits

Table 24–4 displays personnel compensation and benefits (in millions of dollars) for Federal civilian and military personnel of all branches of Government.

Direct compensation of the Federal civilian work force includes base pay and premium pay, such as overtime. In addition, it includes other cash components, such as geographic and other pay differentials (e.g., locality pay, and special pay adjustments for law enforcement officers), recruitment and relocation bonuses, retention allowances, performance awards, and cost-of-living and overseas allowances. Military personnel compensation also includes special and incentive pays (e.g., enlistment and reenlistment bonuses), and allowances for clothing, housing, and subsistence.

Personnel benefits for current employees consists of the cost to Government agencies for health insurance, life insurance, Social Security (old age, survivors, disability, and health insurance) contributions to the retirement funds to finance future retirement benefits, and other items. Compensation for former personnel includes outlays for retirement pay benefits and the Government's share of the cost of health and life insurance.

The U.S. Overseas Staffing Presence

There are approximately 67,000 permanent American and locally hired staff overseas under the authority of Chiefs of Mission (e.g., Ambassadors or Charge d' Affairs at U.S. embassies worldwide). The average cost of an American position overseas in 2007 is projected to be about $491,000. This total includes direct costs, such a salary and overseas allowances, and support costs, such as housing, educational costs for dependents, travel, administrative support and Capital Security Cost Sharing charges.

The Administration is working to improve the safety, efficiency, and accountability in U.S. Government staffing overseas through the Presidential Management Agenda (PMA) initiative on a Right-sized Overseas Presence. Rightsizing is ensuring that the composition of Government agencies and staffing overseas is consistent with our foreign policy goals, security concerns, and overall fiscal constraints.

A key component of this initiative is developing transparent data on overseas staffing, including the cost of maintaining positions overseas, and incorporating this data in the budget process to better inform decision makers on overseas staffing levels. With our foreign policy priorities necessitating increased support to meet new requirements in the Global War on Terror, the fight against global AIDS, and support for emerging democracies, it is important that we be able to deploy our overseas staff resources effectively.

Periodic reviews are another tool to encourage effective deployment of staff overseas. For example, when a new embassy construction project is under development, formal staffing rightsizing reviews are now required. For the new embassy construction projects included in the President 2007 budget, these review resulted in an eight percent reduction in projected staffing needs. These reviews focus on linking staffing to mission goals, eliminating unnecessary duplication, and encouraging shared services and outsourcing. The Department of State plans to review staffing at each existing U.S. mission once every five years.

Overseas Staffing Under Chief of Mission (COM) Authority*

Total Personnel Overseas Under COM Authority (Including American and Locally Engaged Staff) Projected for 2006	Total American Personnel Overseas Under COM Authority Projected for 2006	Average Cost of a U.S. Direct Hire Overseas Estimated for 2007	New Overseas American Positions Funded in the President's 2007 Budget
66,854	14,526	$491,000	303

* As reported by agencies in their 2007 budget submissions

Another element of the rightsizing plan is to consolidate functions, which are not location specific, in regional centers or back to the United States. In 2005, The Department of State opened a new regional center in Frankfurt, Germany that will be used to provide consolidated support services to Europe and parts of Africa and Near East Asia. The Department's new Office of Global Support Services and Innovation is implementing a plan that will systematically regionalize or centralize all non-location specific support services over the next three years, beginning with high-threat danger posts in 2006, to be completed through 2008.

The Administration will continue to build on these Rightsizing initiatives through expanded shared-services and regionalization/centralization, rigorous post level reviews, and an accurate accounting of overseas staffing and costs to strengthen mechanisms to ensure safety, efficiency, and accountability in our U.S. Government personnel presence overseas.

Table 24–1. FEDERAL CIVILIAN EMPLOYMENT IN THE EXECUTIVE BRANCH

(Civilian employment as measured by Full-Time Equivalents, in thousands)

Agency	Actual			Estimate		Change: 2003 to 2007	
	2003	2004	2005	2006	2007	FTE's	Percent
Cabinet agencies:							
Agriculture	101.4	100.5	99.6	100.1	99.1	–2.3	–2.3%
Commerce	34.5	34.6	35.1	37.4	38.2	3.7	10.7%
Defense-military functions	648.9	650.4	653.0	666.7	663.6	14.7	2.3%
Education	4.5	4.4	4.3	4.3	4.3	–0.2	–3.4%
Energy	15.6	15.1	14.9	15.7	15.9	0.3	1.8%
Health and Human Services	60.0	59.3	59.3	61.3	62.0	2.0	3.3%
Homeland Security	144.5	137.3	143.3	146.6	150.3	5.8	4.0%
Housing and Urban Development	10.4	10.2	9.9	9.8	9.4	–1.0	–9.1%
Interior	71.0	70.7	70.4	70.2	69.8	–1.2	–1.7%
Justice	99.4	101.4	103.0	118.5	117.6	18.2	18.3%
Labor	16.9	16.5	16.0	16.8	16.9	....	....
State	29.5	30.0	30.1	30.3	30.5	1.0	3.3%
Transportation	59.0	57.3	55.5	55.4	55.9	–3.1	–5.3%
Treasury	115.4	113.6	110.0	112.5	110.3	–5.1	–4.5%
Veterans Affairs	211.8	218.7	222.0	222.8	223.3	11.5	5.4%
Other agenciesexcluding Postal Service:							
Agency for International Development	2.3	2.2	2.4	2.5	2.7	0.4	17.2%
Broadcasting Board of Governors	2.4	2.3	2.2	2.3	2.2	–0.2	–8.5%
Corps of EngineersCivil Works	24.5	23.5	22.5	22.9	22.5	–2.0	–8.2%
Environmental Protection Agency	17.5	17.3	17.5	17.4	17.6	0.1	0.4%
Equal Employment Opportunity Comm	2.6	2.5	2.4	2.4	2.4	–0.2	–8.4%
Federal Deposit Insurance Corporation	5.4	5.3	4.9	4.2	4.1	–1.3	–24.6%
General Services Administration	12.9	12.6	12.5	12.2	12.0	–0.9	–7.0%
National Aeronautics and Space Admin	18.7	18.8	18.8	18.6	18.2	–0.5	–2.7%
National Archives and Records Administration	2.8	2.8	2.8	2.9	2.9	0.1	3.6%
National Labor Relations Board	1.9	1.9	1.8	1.8	1.8	–0.1	–4.5%
National Science Foundation	1.2	1.3	1.3	1.4	1.4	0.2	15.5%
Nuclear Regulatory Commission	2.9	3.0	3.1	3.3	3.3	0.4	14.1%
Office of Personnel Management	2.8	2.8	3.6	4.5	4.5	1.7	61.9%
Peace Corps	1.0	1.1	1.0	1.1	1.1	0.1	14.8%
Railroad Retirement Board	1.1	1.1	1.0	1.0	0.9	–0.2	–13.8%
Securities and Exchange Commission	3.1	3.6	3.9	3.8	3.7	0.6	18.9%
Small Business Administration	3.8	3.4	4.1	5.2	3.0	–0.8	–21.7%
Smithsonian Institution	5.2	5.1	5.1	5.6	5.6	0.4	8.3%
Social Security Administration	63.1	63.9	64.6	64.0	62.0	–1.1	–1.7%
Tennessee Valley Authority	13.1	12.0	12.6	12.7	12.5	–0.6	–4.5%
All other small agencies	15.1	14.9	14.8	15.7	16.1	1.0	6.4%
Total, Executive Branch civilian employment *	**1,826.2**	**1,821.1**	**1,829.6**	**1,874.2**	**1,867.7**	**41.5**	**2.3%**
Subtotal, Defense	648.9	650.4	653.0	666.7	663.6	14.7	2.3%
Subtotal, Non-Defense	1,177.3	1,170.7	1,176.6	1,207.5	1,204.0	26.7	2.3%

* Totals may not add due to rounding.

Table 24–2. TOTAL FEDERAL EMPLOYMENT

(As measured by total positions filled)

Description	Actual as of September 30			Change: 2003 to 2005	
	2003	2004	2005	Positions	Percent
Executive branch civilian employment:					
All agencies except Postal Service and Postal Rate Commission:					
Full-time permanent	1,646,688	1,662,990	1,663,043	16,355	1.0%
Other than full-time permanent	220,288	218,953	209,157	–11,131	–5.1%
Subtotal	1,866,976	1,881,943	1,872,200	5,224	0.3%
Postal Service: [1]					
Full-time permanent	634,709	609,579	605,120	–29,589	–4.7%
Other than full-time permanent	164,539	158,083	159,090	–5,449	–3.3%
Subtotal	799,248	767,662	764,210	–35,038	–4.4%
Subtotal, Executive branch civilian employment	2,666,224	2,649,605	2,636,410	–29,814	–1.1%
Military personnel on active duty: [2]					
Department of Defense	1,434,377	1,426,836	1,389,394	–44,983	–3.1%
Department of Homeland Security (USCG)	37,472	40,230	40,710	3,238	8.6%
Commissioned Corps (HHS, EPA, NOAA)	6,200	6,357	6,363	163	2.6%
Subtotal, military personnel	1,478,049	1,473,423	1,436,467	–41,582	–2.8%
Subtotal, Executive Branch	4,144,273	4,123,028	4,072,877	–71,396	–1.7%
Legislative branch:					
Full-time permanent	12,044	11,614	11,389	–655	–5.4%
Other than full-time permanent	19,070	18,435	19,427	357	1.9%
Subtotal, Legislative Branch	31,114	30,049	30,816	–298	–1.0%
Judicial Branch:					
Full-time permanent	30,955	30,537	30,765	–190	–0.6%
Other than full-time permanent	3,304	3,324	3,299	–5	–0.2%
Subtotal, Judicial Branch	34,259	33,861	34,064	–195	–0.6%
Grand total [3]	**4,209,646**	**4,186,938**	**4,137,757**	**–71,889**	**–1.7%**
ADDENDUM					
Executive branch civilian personnel (excluding Postal Service):					
DOD civilians—Military functions	636,454	644,251	648,590	12,136	1.9%
All other executive branch	1,230,522	1,237,692	1,223,610	–6,912	–0.6%
Total	**1,866,976**	**1,881,943**	**1,872,200**	**5,224**	**0.3%**

[1] Includes Postal Rate Commission.
[2] Excludes reserve components.
[3] Includes Summer Aides, Stay-in-school, Junior Fellowship, Worker-Trainee Opportunity, and disadvantage youth programs.

Table 24–3. TOTAL FEDERAL EMPLOYMENT

(As measured by Full-Time Equivalents)

Description	2005 Actual	Estimate		Change: 2005 to 2007	
		2006	2007	FTE's	Percent
Executive branch civilian personnel:					
All agencies except Postal Service and Defense	1,176,630	1,207,502	1,204,005	27,375	2.3%
Defense-Military functions (civilians)	652,987	666,663	663,649	10,662	1.6%
Subtotal, excluding Postal Service	1,829,617	1,874,165	1,867,654	38,037	2.1%
Postal Service [1]	744,196	732,348	717,000	–27,196	–3.7%
Subtotal, Executive Branch civilian personnel	2,573,813	2,606,513	2,584,654	10,841	0.4%
Executive branch uniformed personnel: [2]					
Department of Defense	1,408,115	1,375,647	1,347,100	–61,015	–4.3%
Department of Homeland Security (USCG)	40,710	41,139	41,528	818	2.0%
Commissioned Corps (HHS, EPA, NOAA)	6,363	6,404	6,420	57	0.9%
Subtotal, uniformed military personnel	1,455,188	1,423,190	1,395,048	–60,140	–4.1%
Subtotal, Executive Branch	4,029,001	4,029,703	3,979,702	–49,299	–1.2%
Legislative Branch: 3 Total FTE [3]	31,831	32,681	33,004	1,173	3.7%
Judicial branch: Total FTE	32,912	33,681	34,086	1,174	3.6%
Grand total	**4,093,744**	**4,096,065**	**4,046,792**	**–46,952**	**–1.1%**

[1] Includes Postal Rate Commission.
[2] Military personnel on active duty. Excludes reserve components. Data shown for military are average strengths, not FTEs.
[3] FTE data not available for the Senate (positions filled were used).

TABLE 24–4. PERSONNEL COMPENSATION AND BENEFITS

(In millions of dollars)

Description	2005 Actual	2006 Estimate	2007 Request	Change: 2005 to 2007	
				Dollars	Percent
Civilian personnel costs:					
Executive Branch (excluding Postal Service):					
Direct compensation:					
DODmilitary functions	40,899	42,013	42,587	1,688	4.1%
All other executive branch	83,960	88,859	91,337	7,377	8.8%
Subtotal, direct compensation	124,859	130,872	133,924	9,065	7.3%
Personnel benefits:					
DODmilitary functions	10,619	11,151	11,477	858	8.1%
All other executive branch	34,315	35,904	36,885	2,570	7.5%
Subtotal, personnel benefits	44,934	47,055	48,362	3,428	7.6%
Subtotal, executive branch	169,793	177,927	182,286	12,493	7.4%
Postal Service:					
Direct compensation	39,300	40,195	40,953	1,653	4.2%
Personnel benefits	13,084	15,020	15,263	2,179	16.7%
Subtotal	52,384	55,215	56,216	3,832	7.3%
Legislative Branch: [1]					
Direct compensation	1,803	1,871	1,968	165	9.2%
Personnel benefits	482	532	560	78	16.2%
Subtotal	2,285	2,403	2,528	243	10.6%
Judicial Branch:					
Direct compensation	2,556	2,731	2,917	361	14.1%
Personnel benefits	736	799	849	113	15.4%
Subtotal	3,292	3,530	3,766	474	14.4%
Total, civilian personnel costs	227,754	239,075	244,796	17,042	7.5%
Military personnel costs:					
DODMilitary Functions:					
Direct compensation	79,445	74,162	71,421	–8,024	–10.1%
Personnel benefits	38,329	37,055	37,174	–1,155	–3.0%
Subtotal	117,774	111,217	108,595	–9,179	–7.8%
All other executive branch, uniformed personnel:					
Direct compensation	2,407	2,612	2,636	229	9.5%
Personnel benefits	653	724	753	100	15.3%
Subtotal	3,060	3,336	3,389	329	10.8%
Total, military personnel costs [2]	120,834	114,553	111,984	–8,850	–7.3%
Grand total, personnel costs	**348,588**	**353,628**	**356,780**	**8,192**	**2.4%**
ADDENDUM					
Former Civilian Personnel:					
Retired pay for former personnel	56,073	59,579	62,516	6,443	11.5%
Government payment for Annuitants:					
Employee health benefits	7,889	8,204	8,765	876	11.1%
Employee life insurance	38	39	39	1	2.6%
Former Military personnel:					
Retired pay for former personnel	39,166	41,396	43,582	4,416	11.3%
Military annuitants health benefits	6,399	7,097	7,541	1,142	17.8%

[1] Excludes members and officers of the Senate.
[2] Excludes reserve components not on active duty.

CURRENT SERVICES ESTIMATES

25. CURRENT SERVICES ESTIMATES

There has long been a desire to have a neutral benchmark against which policy proposals can be measured. Since the early 1970s when the first requirements for the calculation of a "current services" baseline were enacted, a variety of concepts and measures have been employed. In recent years, the current services baseline has been defined to be identical to the baseline required by the Budget Enforcement Act (BEA). However, that baseline has serious technical flaws, which compromise its ability to serve as a neutral measure. This section provides detailed estimates of a baseline that corrects these flaws. It also discusses alternative formulations for the baseline.

Ideally, a current services baseline would provide a projection of estimated receipts, outlays, deficits or surpluses, and budget authority needed to reflect this year's enacted policies and programs for each year in the future. Because such a concept would be nearly impossible to apply across all segments of the government, the baseline has instead become largely a mechanical construct.

Moreover, it is important to discuss what a baseline is not. The baseline is not a prediction of the final outcome of the annual budget process, nor is it a proposed budget. By itself, the current services baseline commits no one to any particular policy. Instead, the commitments or constraints reflected in the current services estimates are based on the tax and spending policies contained in current law.

The current services baseline is used in a variety of ways: It can warn of future problems, either for Government fiscal policy as a whole or for individual tax and spending programs. It is also a "policy-neutral" benchmark against which the President's Budget and other budget proposals can be compared to measure the magnitude of the proposed changes. The following table shows current services estimates of receipts, outlays, and surpluses for 2005 through 2011. They are based on the economic assumptions described later in this chapter. The estimates are shown on a unified budget basis, i.e., the off-budget receipts and outlays of the Social Security trust funds and the Postal Service Fund are added to the on-budget receipts and outlays to calculate the unified budget totals. The table also shows the current services estimates by major component. The BEA baseline deficits are shown as a memorandum in the table.

Conceptual Basis for Estimates

Receipts and outlays are divided into two categories that are important for calculating the current services estimates: those controlled by authorizing legislation (direct spending and receipts) and those controlled through the annual appropriations process (discretionary spending). Different estimating rules apply to each category. There are numerous alternative rules that could be used to develop current services estimates for both categories. The next section discusses some alternatives that might be considered.

Direct spending and receipts.—Direct spending includes the major entitlement programs, such as social security, medicare, medicaid, Federal employee retirement, unemployment compensation, food stamps and other means-tested entitlements. It also includes such programs as deposit insurance and farm price and income supports, where the Government is legally obligated to make payments under certain conditions. Receipts and direct spending are alike in that they involve ongoing activities that generally operate under permanent authority (they do not require annual authorization), and the underlying statutes generally specify the tax rates or benefit levels that must be collected or paid, and who must pay or who is eligible to receive benefits. The current services baseline assumes that receipts and direct spending programs continue in the future as specified by current law. The budgetary impact of anticipated regulations and administrative actions that are permissible under current law are also reflected in the estimates. This year, because the major deficit reduction package in the Deficit Reduction Act has passed both chambers in Congress with only a small technical difference that is expected to be resolved shortly, the impact of the Act is included here as current law.

If a baseline is intended to reflect current law, then the provisions of law providing spending authority and the authority to collect taxes or other receipts that expire under current law should be assumed to expire. However, the current services baseline assumes extension of several types of authority:

- Expiring provisions affecting excise taxes dedicated to a trust fund are assumed to be extended at current rates. During the projection period of 2006 through 2011, taxes deposited in the Airport and Airway trust fund, which expire on September 30, 2007, are the only taxes affected by this exception.
- Direct spending programs that will expire under current law are assumed to be extended if their 2006 outlays exceed $50 million. For example, Temporary Assistance for Needy Families and child care entitlement to States are scheduled to expire at the end of 2010. The baseline estimates provided here assume continuation of these programs in 2011. However, programs enacted after the enactment of the Balanced Budget Act of 1997 that are explicitly temporary in nature expire in

Table 25–1. BASELINE CATEGORY TOTALS

(In billions of dollars)

	2005	2006	2007	2008	2009	2010	2011
Receipts	2,154	2,301	2,444	2,597	2,729	2,901	3,064
Outlays:							
Discretionary:							
DoD-Military	473	480	440	438	445	456	472
Homeland security	30	32	34	35	35	36	38
Other discretionary	465	486	488	484	493	498	507
Subtotal, discretionary	968	998	962	957	973	990	1,017
Mandatory:							
Social Security	519	550	581	612	645	683	723
Medicare	294	338	390	405	429	457	500
Medicaid and SCHIP	187	198	205	219	234	251	270
Other mandatory	320	365	319	340	359	371	390
Subtotal, mandatory	1,320	1,451	1,495	1,575	1,668	1,762	1,883
Net interest	184	219	244	266	284	298	310
Total outlays	2,472	2,669	2,701	2,798	2,925	3,050	3,210
Unified deficit	–318	–367	–257	–201	–196	–149	–146
On-budget	–494	–549	–449	–416	–428	–402	–420
Off-budget	175	182	192	216	233	252	274
Memorandum:							
BEA baseline deficit	–318	–367	–305	–266	–244	–230	–127
Do not extend emergencies	....	....	45	67	76	82	86
Correct growth rates for pay	....	....	2	3	3	3	3
Remove special rule for administrative expenses of selected programs	....	....	*	*	*	*	1
Extend certain tax provisions	....	*	–1	–8	–37	–14	–119
Related debt service	....	*	1	4	6	9	11
Current baseline deficit	–318	–367	–257	–201	–196	–149	–146

the baseline even if their current year outlays exceed the $50 million threshold.

- Certain provisions in the 2001 and 2003 Tax Acts that were clearly not intended to be temporary are assumed to continue past their expiration date. These provisions include reductions in individual income taxes on capital gains and dividends, increased expensing for small businesses, and reductions in income taxes and estate and gift taxes scheduled to sunset on December 31, 2010. Unlike the two extensions discussed above, the BEA baseline definitions, developed before the enactment of the 2001 and 2003 tax acts, do not provide for extension of these provisions.

Discretionary spending.—Discretionary programs differ in one important aspect from direct spending programs—Congress provides spending authority for almost all discretionary programs one year at a time. The spending authority is normally provided in the form of annual appropriations. Absent appropriations of additional funds in the future, discretionary programs would cease to exist after existing balances were spent. If the baseline was intended to reflect current law, then a baseline would only reflect the expenditure of remaining balances from appropriations laws. Instead the current services baseline provides a mechanical definition for discretionary programs that is somewhat arbitrary. The definition used here attempts to keep discretionary spending level in real terms. For 2006, the current services estimates for discretionary programs are equal to enacted 2006 appropriations. For 2007 through 2011, funding for most accounts is equal to this 2006 level adjusted for inflation. The inflation rates used here are similar to those required by the BEA but adjusted to remove the overcompensation for federal pay inherent in the BEA definition. Unlike the BEA requirements, these current services estimates assume that federal pay raises are effective in January, as required under current law. At the time the BEA was enacted, it ignored the nearly contemporaneous enactment of the Federal Employees Compensation Act of 1991 that shifted the effective date of federal employee pay raises from October to January. Also, the estimates presented here exclude the special adjustment for administrative expenses for certain benefit programs required by the BEA. This provision is inconsistent with the baseline rules for other accounts that fund administrative costs. In addition, the baseline estimates presented here assume that emergency appropriations enacted for 2006, including the response to Hurricane Katrina, funding to address Pandemic Influenza, and funding for the Global War on Terror, are one-time only events. The BEA requires that the baseline assume funding for emergencies repeatedly through the projection period.

Alternative Formulations of Baseline

Throughout much of U.S. history, budget proposals were often compared to either the President's request or the previous year's budget. In the early 1970s, policymakers developed the concept of a baseline to provide a more neutral benchmark for comparisons. While the Congressional Budget Act of 1974 included a requirement that OMB and the Congressional Budget Office (CBO) provide estimates of a current services baseline, the definition of the baseline was very general and specific guidance was not provided.

Subsequent budget acts have specified in increasing detail the requirements for constructing baselines. Current services estimates for direct spending programs and receipts are generally estimated based on laws currently in place and most major programs are assumed to continue even past sunset dates set in law. In the case of receipts, the BEA requires only the extension of trust fund excise taxes, but otherwise bases the estimates on current law. For discretionary programs, these acts instituted a precise definition of baseline with numerous rules for its construction.

It is clear, however, that a number of baseline definitions could be developed that differ for those presented in this chapter:

- *Extend provisions affecting parts of mandatory programs.* Currently, mandatory programs that have current year outlays of over $50 million are generally assumed to continue. However, provisions of law that affect parts of mandatory programs, even those that have been consistently extended in the past, are assumed to expire as scheduled.
- *Do not extend any authorizing laws that expire.* If all mandatory programs were assumed to expire as scheduled, deficits for 2007 through 2011 would be $244 billion lower than the current estimates. (See the section below on major program assumptions for details on mandatory program extensions assumed in the estimates.) If excise taxes were allowed to expire, the deficit would be $54 billion higher over the period 2007 through 2011. If certain provisions of the 2001 and 2003 Tax Acts were assumed to expire, the deficit would be $188 billion lower over the period.
- *Straightline appropriations.* If all discretionary budgetary resources were to be the same in each year in the projection period as provided for the current year, total outlays would be $15 billion lower in 2007 and $350 billion lower over the period 2007 through 2011.
- *Do not extend any appropriations.* The current treatment of expiring provisions is inconsistent with the treatment of discretionary spending. All discretionary spending continues whether there is authorization for the program or not and whether funds have already been provided or not. In nearly all cases, funds for discretionary programs have not been provided in advance for years beyond the current year. If rules consistent with the treatment of other expiring provisions were applied to discretionary spending, no new budgetary resources would be provided. Thus, under a strict "current law" approach, the only discretionary outlays that would be included in the baseline would be the lagged spending from the current year budgetary resource. If this rule were followed, outlays in 2007 would be reduced by $551 billion relative to the current estimates. Clearly this would provide an unrealistic estimate of future spending and the government's future fiscal position.

Table 25–2 provides estimates for a variety of changes in baseline definitions that could be considered.

Economic Assumptions

The current services estimates are based on the same economic assumptions as the President's Budget, which are based on enactment of the President's Budget proposals. The economy and the budget interact. Changes in economic conditions significantly alter the estimates of tax receipts, unemployment benefits, entitlement payments that are automatically adjusted for changes in cost-of-living (COLAs), income support programs for low-income individuals, and interest on the Federal

Table 25–2. ALTERNATIVE BASELINE ASSUMPTIONS

(in billions of dollars)

	2006	2007	2008	2009	2010	2011	2006–2011
Current baseline deficit	–367	–257	–201	–196	–149	–146	–948
Alternative assumptions ("–" represents deficit increase) [1]:							
Extend provisions affecting parts of mandatory programs [2]	....	–*	–1	–1	–1	–2	–5
Do not extend any authorizing laws:							
Mandatory spending	....	1	43	54	60	85	244
Trust fund excise taxes	....	....	–12	–13	–14	–16	–54
Certain provisions of the 2001 and 2003 Tax Acts	–*	1	8	38	16	125	188
Straightline appropriations	....	15	39	67	97	130	350
Do not extend any appropriations	....	551	858	996	1,094	1,184	4,684

[1] Estimates include related debt service.
[2] Estimates provided here are the totals for the illustrative provisions shown in Table 25–5. This is not a complete listing of all provisions that expire

debt. In turn, Government tax and spending policies influence prices, economic growth, consumption, savings, and investment. Because of these interactions, it would be reasonable, from an economic perspective, to assume different economic paths for the current services baseline and the President's Budget. However, this would diminish the value of current services estimates as a benchmark for measuring proposed policy changes, because it would then be difficult to separate the effects of proposed policy changes from the effects of different economic assumptions. By using the same economic assumptions for current services and the President's Budget, this potential source of confusion is eliminated. The economic assumptions underlying both the budget and the current service estimates are summarized in Table 25–3. The economic outlook underlying these assumptions is discussed in greater detail in Chapter 12 of this volume.

Table 25–3. SUMMARY OF ECONOMIC ASSUMPTIONS

(Fiscal years; dollar amounts in billions)

	2006	2007	2008	2009	2010	2011
Gross Domestic Product (GDP):						
Levels, dollar amounts in billions:						
Current dollars	13,030	13,761	14,521	15,296	16,102	16,955
Real, chained (2000) dollars	11,418	11,800	12,187	12,573	12,963	13,364
Percent change, year over year:						
Current dollars	6.0	5.6	5.5	5.3	5.3	5.3
Real, chained (2000) dollars	3.4	3.3	3.3	3.2	3.1	3.1
Inflation measures (percent change, year over year):						
GDP chained price index	2.5	2.2	2.2	2.1	2.1	2.1
Consumer price index (all urban)	3.3	2.4	2.4	2.4	2.4	2.4
Unemployment rate, civilian (percent)	5.0	5.0	5.0	5.0	5.0	5.0
Interest rates (percent):						
91–day Treasury bills	4.1	4.2	4.2	4.3	4.3	4.3
10–year Treasury notes	4.9	5.3	5.5	5.6	5.6	5.6
MEMORANDUM						
Related program assumptions:						
Automatic benefit increases (percent):						
Social security and veterans pensions	4.1	2.6	2.4	2.4	2.4	2.4
Federal employee retirement	4.1	2.6	2.4	2.4	2.4	2.4
Food stamps	1.5	2.7	2.4	2.4	2.4	2.4
Insured unemployment rate	2.2	2.2	2.2	2.2	2.2	2.2

Major Programmatic Assumptions

A number of programmatic assumptions must be made in order to calculate the baseline estimates. These include assumptions about the number of beneficiaries who will receive payments from the major benefit programs and annual cost-of-living adjustments in the indexed programs. Assumptions on baseline caseload projections for the major benefit programs are shown in Table 25–4. Assumptions about various automatic cost-of-living-adjustments are shown in Table 25–3.

It is also necessary to make assumptions about the continuation of expiring programs and provisions. In the estimates provided here, expiring excise taxes dedicated to a trust fund are extended at current rates. Certain income tax provisions from the 2001 and 2003 Tax Acts, that were not designed to be temporary in nature, are assumed to be permanent for purposes of calculating revenue estimates. In general, mandatory programs with current year spending of at least $50 million are also assumed to continue. All discretionary programs with enacted non-emergency appropriations in the current year are assumed to continue. However, specific provisions of law that affect mandatory programs (but are not necessary for program operation) are allowed to expire as scheduled. For example, under the Deficit Reduction Act, medicaid transition assistance will expire at the end of December 2006. The baseline does not assume additional spending under this authority beyond that point. Table 25–5 provides a listing of mandatory programs and taxes assumed to continue in the baseline after their expiration.

Many other important assumptions must be made in order to calculate the baseline estimates. These include assumptions about the timing and substance of regulations that will be issued over the projection period, the use of administrative discretion provided under current law, and other assumptions about the way programs operate. Table 25–5 lists many of these assumptions and their impact on the baseline estimates. It is not intended to be an exhaustive listing; the variety and complexity of Government programs are too great to provide a complete list. Instead, some of the more important assumptions are shown.

Table 25–4. BENEFICIARY PROJECTIONS FOR MAJOR BENEFIT PROGRAMS

(Annual average, in thousands)

	2005 Actual	Estimate					
		2006	2007	2008	2009	2010	2011
Farmer direct payments	1,674	1,780	1,746	1,716	1,695	1,702	1,704
Federal family education loans	5,864	6,213	6,490	6,781	7,102	7,436	7,790
Federal direct student loans	1,806	1,882	1,963	2,049	2,141	2,238	2,339
Medicaid/State Children's Health Insurance Program	53,400	56,200	56,800	57,400	57,900	58,300	58,700
Medicare-eligible military retiree health benefits	1,841	1,872	1,902	1,935	1,966	1,991	2,019
Medicare:							
Hospital insurance	41,874	42,489	43,201	44,027	44,927	45,889	46,973
Supplementary medical insurance	39,462	39,986	40,592	41,300	42,076	42,883	43,778
Railroad retirement	595	585	574	564	556	549	543
Federal civil service retirement	2,413	2,468	2,531	2,564	2,597	2,630	2,661
Military retirement	2,087	2,111	2,135	2,154	2,169	2,178	2,182
Unemployment compensation	8,085	9,044	9,082	9,154	9,222	9,308	9,410
Food stamps	25,681	26,946	25,868	25,390	24,773	24,539	24,451
Child nutrition	32,343	33,158	33,880	34,546	35,139	35,670	36,165
Foster care and adoption assistance	597	623	651	682	713	746	780
Supplemental security income (SSI):							
Aged	1,118	1,111	1,105	1,103	1,102	1,103	1,105
Blind/disabled	5,657	5,803	5,998	6,141	6,245	6,323	6,389
Subtotal, SSI	6,775	6,914	7,103	7,244	7,347	7,426	7,494
Child care and development fund [1]	2,200	2,100	2,000	2,000	1,900	1,900	1,800
Social security (OASDI):							
Old age and survivor insurance	39,844	40,262	40,762	41,389	42,163	43,080	44,070
Disability insurance	8,054	8,424	8,743	9,017	9,251	9,448	9,649
Veterans compensation:							
Veterans	2,601	2,714	2,867	2,989	3,099	3,217	3,333
Survivors (non-veterans)	326	340	349	358	367	377	387
Subtotal, veterans compensation	2,927	3,054	3,216	3,347	3,466	3,594	3,720
Veterans pensions:							
Veterans	338	331	325	319	314	308	303
Survivors (non-veterans)	211	203	195	187	179	172	165
Subtotal, veterans pensions	549	534	520	506	493	480	468

[1] Includes children served through the CCDF (including TANF transfers) and through funds spent directly on child care in the Social Services Block Grant and TANF programs.

Table 25–5. IMPACT OF REGULATIONS, EXPIRING AUTHORIZATIONS, AND OTHER ASSUMPTIONS IN THE BASELINE

(in millions of dollars)

	Estimate					
	2006	2007	2008	2009	2010	2011
REGULATIONS						
Old age and survivors insurance (OASI) and disabilty insurance (DI):						
Ticket to Work and Self-Sufficiency	18	26	27	18	5	–14
Reduction of Title II benefits under family maximum in cases of dual entitlement	17	18	19	20	21	23
Trial work period	3	3	2	1	1	......
Expedited reinstatment of disability benefits	NA	NA	NA	NA	NA	NA
Medicaid: [1]						
Payment Reform	......	–384	–624	–900	–939	–965
Provider Tax Reform	......	......	–230	–460	–690	–690
Medicaid Services Reform	......	–225	–364	–523	–564	–610
Pharmacy Pay and Chase Reform	......	–105	–95	–85	–75	–70
Clarifying Regulations	......	......	......	......	......	......
School-based Services Administration Reform	......	–615	–670	–725	–785	–850
Medicare, HI: [1]						
Long-term care hospitals	......	–280	–480	–550	–570	–600
Inpatient rehabiliation facilities	......	–180	–210	–220	–230	–250
Medicare, SMI: [1]						
Part B covered drugs, supplies, and wheelchairs	–100	–260	–360	–360	–410	–410
Supplemental security income (SSI):						
Ticket to Work and Self-Sufficiency	–12	–12	–6	–3	–7	–19

Table 25–5. IMPACT OF REGULATIONS, EXPIRING AUTHORIZATIONS, AND OTHER ASSUMPTIONS IN THE BASELINE—Continued

(in millions of dollars)

	Estimate					
	2006	2007	2008	2009	2010	2011
Title XVI cross-program recovery	–15	–15	–15	–15	–20	–20
Student earned income exclusion	4	4	4	5	5	5
Expedited reinstatement of disability benefits	NA	NA	NA	NA	NA	NA
EPA Pesticides tolerance fee				–13	–13	–13
EXPIRING AUTHORIZATIONS						
Provisions extended in the baseline (effect of extension):						
Spending:						
Child care entitlement to States						2,917
Child nutrition:						
Summer food service program					360	380
State administrative expenses					191	200
CCC market access, bioenergy and commodity programs:						
Counter-cyclical payment program				1,489	2,193	1,847
Dairy price support program			67	171	204	208
Dairy export incentive program			40	45	48	49
Direct payment program			1,142	5,257	5,257	5,257
Marketing assistance loan and loan deficiency payment program		73	310	1,616	1,407	1,154
Sugar nonrecourse loan program						
Upland cotton foregiven interest			25			
Market access program			200	200	200	200
Export credit guarantee programs			115	115	115	115
Food for progress			154	154	154	154
Bill Emerson Humanitarian Trust			140	140	140	140
Conservation reserve program			408	779	1,242	1,673
Farm security and rural investment			1,915	1,959	2,020	2,174
Food stamps:						
Benefit costs			30,412	30,489	31,103	31,849
State administrative expenses			2,689	2,790	2,896	3,006
Employment and training			347	355	364	373
Other program costs			60	61	63	64
Nutrition assistance for Puerto Rico			1,594	1,632	1,671	1,711
Food donations on Indian reservations			77	80	85	87
The emergency food assistance program commodities			140	140	140	140
Promoting safe and stable families		345	345	345	345	345
Temporary assistance for needy families (TANF) resources:						
State family assistance grants (SFAG)						16,489
SFAG to territories						78
Matching grants to territories						6
Tribal work program						7
Health Marriage and Fatherhood						150
Census survey of program dynamics						10
Trade adjustment assistance—training and income support			547	934	985	1,019
Trade adjustment assistance—farmers			90	90	90	90
Veterans compensation—annual cost of living adjustment		590	1,353	2,185	3,090	4,076
Revenues:						
Excise taxes dedicated to trust funds:						
Airport and Airway trust fund taxes			11,396	12,071	12,784	13,542
Certain provisions for the 2001 tax cut and 2003 jobs and growth tax cut (includes outlay impact)	83	–531	–7,736	–37,023	–13,596	–119,388
Provisions not extended in the baseline (effect of extension):						
Spending:						
Medicare, SMI:						
Medicare low income premium assistance [2]			380	405	430	460
Medicaid:						
Transition benefits [3]		393	554	580	601	625
Promoting safe and stable families:						
Court improvement grants						20
TANF:						
Supplemental grants						319
Welfare research						15
Veterans programs:						
Income verification match				–6	–11	–16
Contract disability medical exams					92	96
Native American veterans housing loans				–1	–1	–1
Hybrid adjustable rate mortgages				4	4	4
Mandatory appropriation for administration of income verification match				11	11	11
Loan guarantees for multifamily transitional housing for homeless veterans						3

Table 25–5. IMPACT OF REGULATIONS, EXPIRING AUTHORIZATIONS, AND OTHER ASSUMPTIONS IN THE BASELINE—Continued

(in millions of dollars)

	Estimate					
	2006	2007	2008	2009	2010	2011
OTHER IMPORTANT PROGRAM ASSUMPTIONS						
Child support enforcement (CSE):						
Alternative penalties for Family Support Act systems and Statewide Disbursement Unit requirements	–224	–7	–7	–7	–7	....
Food stamps:						
Tax offset, recoupment, and general claims collection	–175	–174	–176	–176	–180	–184
Quality control liabilities	–3	–3	–3	–3	–3	–3
Allocation of administrative costs between public assistance programs	–197	–197	–197	–197	–197	–197
Medicare:						
Physicians	58,739	60,984	59,103	59,356	58,650	57,635
Contracting Reform	....	....	–70	–280	–550	–580
Medicaid: [4]						
Financial management recoveries	–480	–505	–545	–588	–634	–685
Vaccines for Children, total program costs	1,958	2,006	1,698	1,688	1,713	1,729
Institutional long term care	35,279	36,476	38,352	40,335	42,471	44,833
Home and community based institutional alternatives	21,334	23,183	25,731	28,495	31,471	34,837
Pharmaceuticals (FFS, net of rebates)	14,931	14,378	15,110	16,132	17,269	18,578
Managed care (including Medicaid MCOs, PHPs, PCCM)	32,569	36,331	39,936	43,597	47,770	52,466
State Children's Health Insurance Program (Title XXI)	5,775	5,244	5,345	5,316	5,311	5,176
Approved Demonstrations and Pilot Programs: [5]						
Medicare, HI:						
Rural Hospice						
Baseline estimate	*	1	1	1	1	....
Demonstration estimate	*	1	1	1	1	....
Mercy Medical SNF						
Baseline estimate	6	2	....	....	....	....
Demonstration estimate	6	2	....	....	....	....
Premier—Hospital Quality Incentive						
Baseline estimate	3,265	....	....	....	....	....
Demonstration estimate	3,299	12	....	....	....	....
Rural Community Hospital [6]						
Baseline estimate	66	47	49	51	54	....
Demonstration estimate	79	56	59	62	59	....
New York Graduate Medical Education						
Baseline estimate	69	69	69	69	....	....
Demonstration estimate	59	48	35	17	....	....
Utah Graduate Medical Education						
Baseline estimate	6	6	....	....	....	....
Demonstration estimate	6	6	....	....	....	....
Medicare, SMI:						
Chronic Care Improvement Program (Medicare Health Support)						
Baseline estimate	....	....	....	....	....	....
Demonstration estimate	175	198	177	....	....	....
Chiropractic						
Baseline estimate	20	10	....	....	....	....
Demonstration estimate	30	14	....	....	....	....
Municipal Health						
Baseline estimate	15	4	....	....	....	....
Demonstration estimate	29	8	....	....	....	....
Diabetes (Telemedicine)						
Baseline estimate	7	4	....	....	....	....
Demonstration estimate	7	4	....	....	....	....
United Mine Workers Program—Prescription Drug Benefits						
Baseline estimate	26	37	....	....	....	....
Demonstration estimate	114	118	....	....	....	....
BIPA Disease Management						
Baseline estimate	582	318	....	....	....	....
Demonstration estimate	582	318	....	....	....	....
Coordinated Care						
Baseline estimate	174	178	90	....	....	....
Demonstration estimate	151	158	79	....	....	....
Medicare Replacement Drug						
Baseline estimate	....	....	....	....	....	....
Demonstration estimate	149	....	....	....	....	....
Disease Management for Chronically Ill Dual Beneficiaries (Lifemasters)						
Baseline estimate	584	679	164	....	....	....
Demonstration estimate	526	613	149	....	....	....

Table 25–5. IMPACT OF REGULATIONS, EXPIRING AUTHORIZATIONS, AND OTHER ASSUMPTIONS IN THE BASELINE—Continued

(in millions of dollars)

	Estimate					
	2006	2007	2008	2009	2010	2011
Medicare Lifestyle Modification Program						
Baseline estimate	2	1	....	....	....	....
Demonstration estimate	1	1	....	....	....	....
Oncology/quality of care						
Baseline estimate	....	....	....	....	....	....
Demonstration estimate	100	....	....	....	....	....
Care Management for High-Cost Beneficiaries						
Baseline estimate	NA	....	....	....	....	....
Demonstration estimate	61	95	82	13	....	....
Low Vision Rehabilitation						
Baseline estimate	1	2	2	2	2	1
Demonstration estimate	1	4	4	4	4	2
Medicare: HI and SMI:						
ESRD Disease Management						
Baseline estimate	150	240	278	287	75	....
Demonstration estimate	149	239	277	286	74	....
Home Health Third Party Liability						
Baseline estimate	173	191	174	31	....	....
Demonstration estimate	171	186	171	28	....	....
Homebound						
Baseline estimate	....	....	....	....	....	....
Demonstration estimate	1	1	....	....	....	....
Medicare+Choice Phase I						
Baseline estimate	....	....	....	....	....	....
Demonstration estimate	6	3	....	....	....	....
Medicare+Choice Phase II						
Baseline estimate	195	....	....	....	....	....
Demonstration estimate	210	35	....	....	....	....
SHMO-ESRD						
Baseline estimate	4	....	....	....	....	....
Demonstration estimate	4	....	....	....	....	....
S/HMO I—Medicare						
Baseline estimate	1,140	1,534	515	....	....	....
Demonstration estimate	1,368	1,741	584	....	....	....
S/HMO II—Medicare						
Baseline estimate	507	629	202	....	....	....
Demonstration estimate	608	711	228	....	....	....
Physician Group Practice						
Baseline estimate	1,702	1,793	454	....	....	....
Demonstration estimate	1,618	1,666	459	77	....	....
United Mine Workers Program—Health Benefits						
Baseline estimate	415	440	....	....	....	....
Demonstration estimate	404	420	....	....	....	....
Medicaid: [5]						
Alabama Family Planning	31	....	....	....	....	....
Arizona AHCCCS	3,300	....	....	....	....	....
Arkansas (ARKids B)	81	91	102	....	....	....
Arkansas Family Planning Services	61	....	....	....	....	....
Arkansas Independent Choices (Cash & Counseling)	9	2	....	....	....	....
Arkansas TEFRA	30	32	8	....	....	....
California Family Planning	612	....	....	....	....	....
California In-Home Supportive Services Plus	280	325	378	357	....	....
California—MediCal Hospital/Unisured Care	601	766	766	766	702	....
Colorado Consumer Directed Attendant Support	17	19	3	....	....	....
Delaware—Diamond State Health Plan	504	129	....	....	....	....
District of Columbia Childless Adults 50–64	5	3	....	....	....	....
District of Columbia HIV	8	11	14	18	6	....
Florida Consumer Directed Care Plus (Cash & Counseling)	57	61	26	....	....	....
Florida Family Planning	8	....	....	....	....	....
Florida MEDS-AD Program	680	975	1,072	1,180	1,298	....
Hawaii Health QUEST	85	....	....	....	....	....
Illinois Family Planning	387	414	442	....	....	....
IowaCare	102	109	117	125	134	....
Kentucky Health Care Partnership Program	482	513	568	48	....	....
Maine HIV	9	7	....	....	....	....
Maryland (Health Choice)	1,578	1,610	1,086	....	....	....
Massachusetts MassHealth	2,569	2,757	2,960	....	....	....

Table 25–5. IMPACT OF REGULATIONS, EXPIRING AUTHORIZATIONS, AND OTHER ASSUMPTIONS IN THE BASELINE—Continued

(in millions of dollars)

	Estimate					
	2006	2007	2008	2009	2010	2011
Minnesota (Prepaid Med. Assist. Project Plus)	156	186	148			
Minnesota Family Planning	217	248				
Mississippi Family Planning	134	146				
Mississippi—Healthier Mississippi	65	71	78	86		
Missouri Managed Care Plus	204	86				
Montana Basic Medicaid for Able-Bodied Adults	32	35	39	13		
New Jersey Personal Preference (Cash & Counseling)	4	5	3			
New Mexico—Family Planning Expansion	11					
New York (Partnership Plan)	5,252					
North Carolina Family Planning	392	424	457	494		
Oklahoma Family Planning	153	159	166			
Oregon Family Planning	77					
Oregon Independent Choices	3	1				
Rhode Island Rite Care (Medicaid)	179	192	169			
South Carolina Family Planning	26					
TennCare II	3,865	3,124				
Utah (Primary Care Network)	97	79				
Vermont Long Term Care Plan	116	129	143	159	176	
Vermont Global Commitment to Health	492	494	538	586	639	160
Virginia—Family Planning	171	176				
Washington (Take Charge/Family Planning)	170					
Wisconsin Badger Care (Medicaid)	42	18				
Wisconsin Family Planning	20	23				
Pharmacy plus (demonstration estimate):						
Wisconsin Pharmacy Plus	126	150				
Florida Pharmacy Plus	24					
Illinois Pharmacy Plus	26					
South Carolina Pharmacy Plus	11					
State Children's Health Insurance Program (Title XXI) (demonstration estimates):						
Alaska	9	9	10	11		
Maryland Health Choice [7]	139	150				
Minnesota Care						
Demonstration estimate (SCHIP funds)	53	39	41	39		
Baseline estimate (medicaid funds)						
Missouri MC+c [7]	108	56				
New Jersey FamilyCare [8]	132	167	173			
New Mexico SCHIP [7]	25	26				
Rhode Island (SCHIP RiteCare) [8]	30	34	11			
Wisconsin (BadgerCare)	84	88				
Health Insurance Flexibility and Accountability (HIFA) (demonstration estimate—SCHIP funds):						
Arizona HIFA—amendment to AHCCCS	43					
Colorado HIFA	11					
Idaho HIFA	19	21	23	18		
Illinois HIFA (KidCare Parent Coverage)						
Demonstration estimate	133	159				
Baseline estimate (medicaid funds)	5	6				
Maine HIFA (Maine Care for Childless Adults)						
Baseline estimate (medicaid funds)	102	102				
Michigan HIFA	127	120	112	24		
New Mexico HIFA	18	21	24	27		
Oklahoma Sooner Care Demo+HIFA						
Baseline estimate (medicaid funds)	906	230				
Oregon HIFA (Oregon Health Plan 2)						
Demonstration estimate (SCHIP funds)	15	16				
Baseline estimate (medicaid funds)	1,467	1,603				
Virginia HIFA	11	12	12	13		
Joint Medicare and Medicaid: [9]						
Minnesota-Dual Eligibles						
Baseline estimate	600	1,231	308			
Demonstration estimate	599	1,231	308			
Wisconsin-Dual Eligibles						
Baseline estimate	88	95	24			
Demonstration estimate [10]	88	95	24			
Massachusetts—Dual Eligibles						
Demonstration estimate	62	85	21			
Baseline estimate	62	85	21			

Table 25–5. IMPACT OF REGULATIONS, EXPIRING AUTHORIZATIONS, AND OTHER ASSUMPTIONS IN THE BASELINE—Continued

(in millions of dollars)

	Estimate					
	2006	2007	2008	2009	2010	2011
OASI, DI, SSI:						
Performance of continuing disability reviews (baseline levels) (OASI, DI, SSI)	–95	–460	–1,010	–1,600	–2,195	–2,900
Collection of overpayments:						
OASI	–630	–678	–678	–678	–678	–678
DI	–522	–581	–581	–581	–581	–581
SSI (federal)	–884	–960	–960	–960	–960	–960
Debts written off as uncollectable (no effect on outlays):						
OASI	126	135	135	135	135	135
DI	411	458	458	458	458	458
SSI (federal)	353	383	383	383	383	383
OASDI:						
Payments to states for vocational rehabilitation	77	80	87	95	102	110
DI:						
Research and demonstration projects	38	59	54	27	....	....
SSI:						
Payments from states for state supplemental benefits	–4,240	–4,560	–4,725	–4,917	–5,083	–5,219
Payments for state supplemental benefits	4,240	4,175	4,715	4,900	5,070	5,645
Fees for administration of State supplement:						
Treasury share	–138	–130	–144	–146	–148	–161
SSA share	–119	–122	–124	–127	–130	–132
Research and demonstration projects	37	27	27	28	28	29
Payments to states for vocational rehabilitation	51	53	56	59	63	67
Performance of non-disability redeterminations (excludes related overpayment collections reported above)	–390	–1,180	–1,490	–1,570	–1,650	–1,730
State grants and demonstrations—health care:						
Ticket to work grant programs:						
Infrastructure grant program	17	17	20	20	32	35
Demonstration to maintain independence and employment	21	21	22	22	10	10
High risk pools:						
Initial seed grants	....	....	....	....	....	....
Operation of pools	21	....	....	....	....	....
Emergency health services for undocumented aliens	150	175	200	175	175	125
Pilot program for national and state background checks	8	8	7	....	....	....
State pharmaceutical assistance programs	32	50	30	....	....	....
Health care infrastructure improvement program	140	1	....	....	....	....
TANF:						
Work verification penalties	....	....	....	–7	–16	–28

* = $500,000 or less.
NA = Not available.
1 Medicare and medicaid regulations reflect gross outlays.
2 Current law extends program through September 30, 2007.
3 Deficit Reduction Act extends program through December 31, 2006.
4 Not shown on table are anticipated collections from various state liabilities under current law.
5 Baseline estimates reflect costs absent the demonstration; demonstration estimate reflects costs of the demonstration. The differences represent the net impact of the demonstration.
6 Costs of this demonstration are offset annually by a reduction to inpatient hospital prospective payment rates.
7 Estimates reflect costs for SCHIP children under the State's Medicaid 1115.
8 States project covering a portion or their entire demonstration population with medicaid funds.
9 Large enrollment increases due to passive enrollment in Medicare Advantage Special Needs Plan demonstration. Enrollees would be in other Medicare Advantage plans in the absence of demonstrations.
10 Demonstration estimate includes Medicare and Medicaid Federal Share. Medicare share is 50% and 60%, respectively for 2006 and 2007. Medicaid share is 38% and 46%.

Current Services Receipts, Outlays, and Budget Authority

Receipts.—Table 25–6 shows baseline receipts by major source. Total receipts are projected to increase by $143 billion from 2006 to 2007 and by $620 billion from 2007 to 2011, largely due to assumed increases in incomes resulting from both real economic growth and inflation.

Individual income taxes are estimated to increase by $108 billion from 2006 to 2007 under baseline assumptions. This growth of 10.6 percent is primarily the effect of increased collections resulting from rising personal incomes. Individual income taxes are projected to grow at an annual rate of 7.3 percent between 2007 and 2011.

Table 25–6. BASELINE RECEIPTS BY SOURCE

(In billions of dollars)

	2005 Actual	Estimate					
		2006	2007	2008	2009	2010	2011
Individual income taxes	927	1,011	1,119	1,211	1,276	1,383	1,486
Corporation income taxes	278	279	265	273	284	292	302
Social insurance and retirement receipts	794	841	884	931	979	1,036	1,095
On-budget	217	231	242	252	263	277	293
Off-budget	577	610	642	679	716	758	802
Excise taxes	73	74	75	76	78	79	83
Estate and gift taxes	25	28	24	24	26	20	2
Other	56	69	77	82	86	92	97
Total	2,154	2,301	2,444	2,597	2,729	2,901	3,064
On-budget	1,576	1,691	1,802	1,918	2,013	2,142	2,262
Off-budget	577	610	642	679	716	758	802

Corporation income taxes under current law are estimated to decline by $14 billion or 5.0 percent between 2006 and 2007, in large part due to economic factors and legislated tax changes. Corporation income taxes are projected to increase at an annual rate of 3.3 percent from 2007 to 2011, reflecting higher corporate profits.

Social insurance and retirement receipts are estimated to increase by $43 billion between 2006 and 2007, and by an additional $211 billion between 2007 and 2011. The estimates reflect assumed increases in total wages and salaries paid, and scheduled increases in the social security taxable earnings base from $94,200 in 2006 to $119,400 in 2011.

Excise taxes are estimated to increase by $10 billion from 2006 to 2011, in large part due to increased economic activity and the expiration of various excise tax credits. Estate and gift taxes remain relatively level until 2010 when the estate tax is repealed. Other baseline receipts (customs duties and miscellaneous receipts) are projected to increase by $28 billion from 2006 to 2011.

Outlays.—Current services outlays are estimated to grow from $2,669 billion in 2006 to $2,701 billion in 2007, a 1.2 percent increase. Between 2006 and 2011, they are projected to increase at an average annual rate of 3.8 percent. However, quirks in the calendar somewhat distort this comparison. When October 1 falls on a weekend, military pay and certain benefit payments are paid the previous Friday, shifting them into the previous fiscal year. Outlays for 2006 are relatively low because payments shifted from 2006 into 2005 while estimates for 2011 include $23 billion in payments that have shifted from 2012. After adjustment for timing shifts, the average annual rate of growth between 2006 and 2011 is 3.6 percent.

Even though most discretionary spending is assumed to grow with inflation, outlays for discretionary programs decline from $998 billion in 2006 to $962 billion in 2007 and $957 billion in 2008 because the baseline assumes no additional spending for the war or Katrina-related disasters beyond what is already enacted. Outlays increase each year thereafter, reflecting increases in resources to keep pace with inflation, reaching $1,017 billion in 2011. Entitlement and other mandatory programs are estimated to grow from $1,451 billion in 2006 to $1,495 billion in 2007, and to $1,883 billion in 2011, due in large part to changes in the number of beneficiaries and to automatic cost-of-living adjustments and other adjustments for inflation. Social security outlays grow from $550 billion in 2006 to $723 billion in 2011, an average annual rate of 5.6 percent. Medicare and medicaid are projected to grow at annual average rates of 8.1 (7.4 after adjustment for timing shifts) and 6.6 percent, respectively, outpacing inflation. Other areas of growth include federal employee retirement (average annual growth of 3.9 percent), unemployment compensation (5.6 percent) and veterans programs (8.8 percent, but 7.4 percent after adjustment for timing shifts).

Partially offsetting this growth, outlays for flood insurance and higher education decline from high levels in 2006. Flood insurance is estimated to spike to $18 billion in 2006 due to large claims related to Katrina. For 2007 and beyond, the program returns to its normal level. Likewise, higher education spending is projected to remain very high in 2006 as people take advantage of favorable conditions in which to refinance loans. Projections for 2007 and beyond assume that this trend will not continue as interest rates remain relatively level. Undistributed offsetting receipts spike in 2007, reflecting expected large one-time payments from auctions of electromagnetic spectrum, and thus contribute to lower total outlays in that year.

Farm program spending is also projected to decline through the projection period reflecting changes in market supply and demand. For the first time, the Budget incorporates probabilistic price and production variability into its baseline for Commodity Credit Corporation programs for feed grains, wheat, rice, upland cotton, soybeans, and dairy. Previously, farm program outlays projections were based solely on a point estimate or deterministic approach. Because some commodity support programs protect producer income only when prices fall below targeted levels, deterministic projections, by their nature, tend to underestimate outlays. Probabilistic outlay estimates account for the price and corresponding outlay variability around the deterministic estimate. The change in methodology has increased commodity outlay projections by about $11 billion over the 2006 through 2011 period relative to deterministic projections.

Net interest payments to the public total $219 billion in 2006 and $244 billion in 2007. They then continue to rise each year reaching $310 billion in 2011. This pattern reflects increased borrowing requirements as well as changes in the mix of debt issuance and interest rates over the period.

Tables 25–8 and 25–9 show current services outlays by function and by agency, respectively. A more detailed presentation of outlays (by function, subfunction, category, and program) appears on the CD-ROM that accompanies this volume.

Budget authority.—Tables 25–10 and 25–11 show current services estimates of budget authority by function and by agency, respectively. A more detailed presentation of budget authority with program level estimates appears on the CD-ROM that accompanies this volume.

Table 25–7. CHANGE IN BASELINE OUTLAY ESTIMATES BY CATEGORY

(Dollar amounts In billions)

	2006	2007	2011	Change 2006 to 2007		Change 2001 to 2011	
				Amount	Percent	Amount	Average Annual Rate
Outlays:							
Discretionary:							
DoD-Military	480	440	472	–40	–8.3%	–8	–0.3%
Homeland security	32	34	38	2	6.2%	6	3.3%
Other discretionary	486	488	507	2	0.4%	21	0.9%
Subtotal, discretionary	998	962	1,017	–36	–3.6%	18	0.4%
Mandatory:							
Farm programs	22	21	16	–1	–3.8%	–6	–6.4%
Flood insurance	18	*	*	–17	–99.1%	–17	–66.1%
Higher education	11	5	7	–6	–55.7%	–4	–9.7%
Medicaid	192	199	265	7	3.7%	73	6.6%
Medicare	338	390	500	52	15.3%	162	8.1%
Federal employee retirement and disability	99	104	120	5	4.9%	21	3.9%
Unemployment compensation	36	38	47	2	5.2%	11	5.6%
Other income security programs	171	170	195	–1	–0.4%	24	2.7%
Social Security	550	581	723	31	5.7%	173	5.6%
Veterans programs	38	39	57	1	4.0%	20	8.8%
Other mandatory programs	36	38	37	2	5.2%	*	0.1%
Credit sudsidy reestimates	10	....	....	–10	NA	–10	NA
Undistributed offsetting receipts	–69	–91	–83	–22	31.3%	–14	3.7%
Subtotal, mandatory	1,451	1,495	1,883	43	3.0%	431	5.3%
Net interest	219	244	310	25	11.4%	91	7.2%
Total outlays	2,669	2,701	3,210	32	1.2%	541	3.8%
Memorandum:							
Timing shifts caused by calendar	4	3	–23	....	....	....	....
Total outlays adjusted for timing shifts	2,672	2,704	3,187	32	1.2%	515	3.6%

Table 25–8. CURRENT SERVICES OUTLAYS BY FUNCTION

(in billions of dollars)

Function	2005 Actual	Estimate 2006	2007	2008	2009	2010	2011
National defense:							
Department of Defense—Military	474.2	482.0	442.2	439.7	447.2	458.4	474.1
Other	21.2	23.9	23.9	23.8	24.2	24.6	25.1
Total, National defense	495.3	505.9	466.0	463.5	471.3	483.0	499.2
International affairs	34.6	34.8	32.5	32.3	32.0	32.2	32.8
General science, space, and technology	23.7	24.0	25.0	25.4	26.3	26.6	27.2
Energy	0.4	2.6	1.1	2.3	2.1	2.4	2.6
Natural resources and environment	28.0	32.7	33.1	33.3	34.4	35.6	36.6
Agriculture	26.6	26.8	27.0	25.1	23.7	22.8	22.6
Commerce and housing credit	7.6	7.9	9.6	6.9	5.8	3.9	3.5
On-Budget	(9.4)	(9.4)	(9.4)	(10.3)	(9.3)	(8.1)	(7.2)
Off-Budget	(–1.8)	(–1.5)	(0.2)	(–3.4)	(–3.6)	(–4.2)	(–3.7)
Transportation	67.9	71.6	76.9	77.6	78.9	79.9	81.7
Community and regional development	26.3	47.0	26.8	20.6	20.8	16.6	14.7
Education, training, employment, and social services	97.5	109.7	89.9	89.9	92.2	94.6	96.6
Health	250.6	267.1	276.4	291.6	308.2	327.1	349.1
Medicare	298.6	343.0	394.5	410.0	434.8	462.1	505.2
Income security	345.8	360.6	367.0	382.4	391.7	402.5	418.9
Social security	523.3	554.7	586.1	616.8	650.6	688.6	728.4
On-Budget	(16.5)	(16.0)	(18.3)	(21.4)	(22.1)	(23.8)	(27.4)
Off-Budget	(506.8)	(538.7)	(567.7)	(595.4)	(628.5)	(664.8)	(700.9)
Veterans benefits and services	70.2	70.4	72.6	79.2	83.3	87.3	95.2
Administration of justice	40.0	41.3	43.5	42.8	44.1	45.5	47.0
General government	17.0	19.0	20.1	20.1	20.4	21.0	21.9
Net interest	184.0	218.8	243.7	265.9	283.8	298.0	310.3
On-Budget	(275.8)	(316.2)	(349.5)	(381.6)	(411.6)	(438.4)	(464.6)
Off-Budget	(–91.8)	(–97.4)	(–105.7)	(–115.7)	(–127.8)	(–140.4)	(–154.3)
Allowances	....	....	....	....	....	....	....
Undistributed offsetting receipts:							
Employer share, employee retirement (on-budget)	–48.0	–48.5	–49.8	–51.9	–54.3	–56.8	–59.5
Employer share, employee retirement (off-budget)	–10.9	–11.7	–12.2	–12.8	–13.5	–14.2	–15.0
Rents and royalties on the Outer Continental Shelf	–6.1	–9.1	–9.5	–9.2	–9.1	–8.8	–8.8
Sale of major assets	....	....	....	–0.3	....	....	....
Other undistributed offsetting receipts	–0.2	–0.1	–19.7	–13.3	–2.9	–0.1	–0.1
Total, Undistributed offsetting receipts	–65.2	–69.4	–91.2	–87.6	–79.7	–79.9	–83.4
On-Budget	(–54.3)	(–57.8)	(–79.0)	(–74.8)	(–66.2)	(–65.7)	(–68.4)
Off-Budget	(–10.9)	(–11.7)	(–12.2)	(–12.8)	(–13.5)	(–14.2)	(–15.0)
Total	**2,472.2**	**2,668.5**	**2,700.7**	**2,798.0**	**2,924.7**	**3,049.8**	**3,209.8**
On-Budget	(2,070.0)	(2,240.5)	(2,250.6)	(2,334.6)	(2,441.1)	(2,543.8)	(2,682.0)
Off-Budget	(402.2)	(428.1)	(450.1)	(463.5)	(483.7)	(506.0)	(527.8)

Table 25–9. CURRENT SERVICES OUTLAYS BY AGENCY

(in billions of dollars)

Agency	2005 Actual	Estimate					
		2006	2007	2008	2009	2010	2011
Legislative Branch	4.0	4.4	4.2	4.4	4.6	4.7	4.9
Judicial Branch	5.6	6.1	6.1	6.3	6.5	6.7	7.0
Agriculture	85.3	95.7	95.0	94.6	94.3	95.2	97.3
Commerce	6.2	6.5	6.7	7.5	8.1	7.6	7.5
Defense—Military	474.4	482.0	442.2	439.7	447.2	458.4	474.1
Education	72.9	84.0	65.4	66.0	67.7	69.6	71.1
Energy	21.3	21.7	21.8	22.5	22.8	23.5	24.0
Health and Human Services	581.5	641.5	701.0	730.1	770.2	816.3	880.7
Homeland Security	39.3	61.7	42.5	37.3	38.2	34.5	33.9
Housing and Urban Development	42.5	46.8	43.7	43.4	43.0	43.0	43.4
Interior	9.1	9.1	10.2	10.5	11.0	11.4	11.6
Justice	22.7	22.3	25.3	23.8	24.6	25.3	26.2
Labor	47.0	51.4	51.6	53.5	56.1	59.0	61.9
State	12.8	13.6	14.0	14.5	14.6	14.8	15.1
Transportation	56.9	61.3	65.5	65.7	66.5	67.2	68.4
Treasury	408.7	450.8	492.5	531.1	566.1	599.1	631.5
Veterans Affairs	70.0	70.4	72.5	79.0	83.0	87.1	95.0
Corps of Engineers—Civil Works	4.8	7.4	6.3	5.7	5.9	6.1	6.3
Other Defense Civil Programs	43.5	45.7	47.2	48.6	49.6	50.2	50.5
Environmental Protection Agency	7.9	7.9	8.0	8.3	8.4	8.6	8.8
Executive Office of the President	7.7	7.4	2.4	1.1	0.4	0.4	0.4
General Services Administration	0.1	0.4	1.0	0.4	0.5	0.5	0.5
International Assistance Programs	15.0	16.3	16.6	17.1	17.3	17.3	17.6
National Aeronautics and Space Administration	15.6	15.6	16.4	16.9	17.6	17.7	18.2
National Science Foundation	5.4	5.8	5.7	5.8	5.9	6.1	6.2
Office of Personnel Management	59.5	63.5	67.3	70.7	73.7	76.5	78.8
Small Business Administration	2.5	1.2	0.5	0.5	0.6	0.6	0.6
Social Security Administration	561.3	592.4	622.6	658.9	694.4	734.0	779.6
On-Budget	(54.5)	(53.7)	(54.9)	(63.4)	(66.0)	(69.2)	(78.6)
Off-Budget	(506.8)	(538.7)	(567.7)	(595.4)	(628.5)	(664.8)	(700.9)
Other Independent Agencies	14.8	14.4	18.7	16.3	16.5	15.5	16.1
On-Budget	(16.6)	(15.9)	(18.4)	(19.7)	(20.1)	(19.7)	(19.8)
Off-Budget	(–1.8)	(–1.5)	(0.2)	(–3.4)	(–3.6)	(–4.2)	(–3.7)
Allowances	....	....	....	....	....	....	....
Undistributed Offsetting Receipts	–226.2	–238.6	–272.3	–282.3	–290.7	–307.0	–327.2
On-Budget	(–123.4)	(–129.5)	(–154.4)	(–153.8)	(–149.4)	(–152.4)	(–157.9)
Off-Budget	(–102.8)	(–109.1)	(–117.9)	(–128.5)	(–141.2)	(–154.6)	(–169.4)
Total	**2,472.2**	**2,668.5**	**2,700.7**	**2,798.0**	**2,924.7**	**3,049.8**	**3,209.8**
On-Budget	(2,070.0)	(2,240.5)	(2,250.6)	(2,334.6)	(2,441.1)	(2,543.8)	(2,682.0)
Off-Budget	(402.2)	(428.1)	(450.1)	(463.5)	(483.7)	(506.0)	(527.8)

Table 25–10. CURRENT SERVICES BUDGET AUTHORITY BY FUNCTION

(in billions of dollars)

Function	2005 Actual	Estimate					
		2006	2007	2008	2009	2010	2011
National defense:							
Department of Defense—Military	483.9	468.2	424.5	437.0	449.8	463.1	476.8
Other	21.9	23.7	23.4	23.9	24.3	24.8	25.3
Total, National defense	505.8	491.8	447.9	460.9	474.2	487.9	502.1
International affairs	32.9	27.7	30.7	32.5	33.3	34.2	35.1
General science, space, and technology	24.4	24.9	25.2	25.8	26.4	27.0	27.6
Energy	1.3	1.6	1.4	2.1	2.0	2.4	2.6
Natural resources and environment	33.0	33.0	32.3	32.8	34.3	35.7	36.8
Agriculture	29.2	24.7	28.6	25.3	23.6	23.0	22.7
Commerce and housing credit	14.2	12.1	17.2	17.1	13.2	13.2	13.7
On-Budget	(13.2)	(10.0)	(13.4)	(16.2)	(12.4)	(12.8)	(13.2)
Off-Budget	(1.0)	(2.0)	(3.9)	(0.9)	(0.8)	(0.4)	(0.5)
Transportation	76.2	75.4	81.0	82.7	75.7	85.0	86.0
Community and regional development	84.5	16.7	11.5	12.2	12.4	12.6	12.8
Education, training, employment, and social services	99.9	114.2	91.7	94.1	96.6	99.3	100.7
Health	251.8	292.8	276.1	293.2	313.1	331.0	353.4
Medicare	303.4	360.5	394.2	409.9	435.1	461.8	505.2
Income security	349.0	352.3	368.1	382.3	393.5	405.2	423.3
Social security	531.7	557.9	588.6	619.4	653.5	691.9	731.8
On-Budget	(16.5)	(16.0)	(18.3)	(21.4)	(22.1)	(23.8)	(27.4)
Off-Budget	(515.1)	(541.8)	(570.3)	(598.0)	(631.4)	(668.1)	(704.3)
Veterans benefits and services	69.2	70.4	76.2	80.0	84.1	88.1	92.1
Administration of justice	40.6	40.8	43.5	43.1	44.5	46.0	47.5
General government	16.9	19.8	20.4	20.7	21.4	21.9	22.7
Net interest	184.0	218.8	243.7	265.9	283.8	298.0	310.3
On-Budget	(275.8)	(316.2)	(349.5)	(381.6)	(411.6)	(438.4)	(464.6)
Off-Budget	(–91.8)	(–97.4)	(–105.7)	(–115.7)	(–127.8)	(–140.4)	(–154.3)
Allowances	....	....	....	....	....	....	....
Undistributed offsetting receipts:							
Employer share, employee retirement (on-budget)	–48.0	–48.5	–49.8	–51.9	–54.3	–56.8	–59.5
Employer share, employee retirement (off-budget)	–10.9	–11.7	–12.2	–12.8	–13.5	–14.2	–15.0
Rents and royalties on the Outer Continental Shelf	–6.1	–9.1	–9.5	–9.2	–9.1	–8.8	–8.8
Sale of major assets	....	....	....	–0.3	....	....	....
Other undistributed offsetting receipts	–0.2	–0.1	–19.7	–13.3	–2.9	–0.1	–0.1
Total, Undistributed offsetting receipts	–65.2	–69.4	–91.2	–87.6	–79.7	–79.9	–83.4
On-Budget	(–54.3)	(–57.8)	(–79.0)	(–74.8)	(–66.2)	(–65.7)	(–68.4)
Off-Budget	(–10.9)	(–11.7)	(–12.2)	(–12.8)	(–13.5)	(–14.2)	(–15.0)
Total	**2,582.9**	**2,665.8**	**2,687.1**	**2,812.7**	**2,941.0**	**3,084.4**	**3,243.0**
On-Budget	(2,169.5)	(2,231.1)	(2,230.9)	(2,342.2)	(2,450.1)	(2,570.5)	(2,707.6)
Off-Budget	(413.4)	(434.7)	(456.2)	(470.4)	(490.9)	(513.9)	(535.5)
MEMORANDUM							
Discretionary budget authority:							
National defense	499.8	488.3	444.6	457.8	471.1	484.8	499.0
International	34.7	31.5	32.1	32.9	33.7	34.5	35.3
Domestic	450.4	382.0	391.8	403.3	414.3	425.6	437.1
Total	**984.9**	**901.8**	**868.6**	**894.0**	**919.1**	**944.9**	**971.4**

Table 25–11. CURRENT SERVICES BUDGET AUTHORITY BY AGENCY

(in billions of dollars)

Agency	2005 Actual	Estimate					
		2006	2007	2008	2009	2010	2011
Legislative Branch	4.1	4.2	4.4	4.5	4.7	4.9	5.1
Judicial Branch	5.7	6.0	6.2	6.4	6.6	6.9	7.1
Agriculture	95.0	96.3	99.6	96.9	96.6	98.1	100.3
Commerce	6.5	6.4	6.8	9.2	7.2	7.4	7.7
Defense—Military	483.9	468.2	424.5	437.0	449.8	463.1	476.8
Education	74.6	88.6	66.4	68.3	70.3	72.4	73.2
Energy	21.2	21.0	21.2	22.4	22.9	23.5	24.1
Health and Human Services	591.5	676.9	700.3	731.5	773.2	819.4	886.5
Homeland Security	101.3	22.7	29.8	31.0	34.0	32.6	33.5
Housing and Urban Development	35.1	47.8	37.7	38.7	39.6	40.6	41.6
Interior	10.4	9.3	10.2	10.4	11.0	11.5	11.6
Justice	22.1	22.6	24.8	23.9	24.7	25.6	26.4
Labor	47.2	51.3	52.6	55.1	57.5	60.1	62.7
State	14.7	13.6	13.9	14.2	14.6	15.0	15.4
Transportation	64.9	64.6	69.3	70.6	63.2	72.1	72.6
Treasury	410.2	452.5	494.1	532.6	567.9	600.9	633.2
Veterans Affairs	69.1	70.4	76.0	79.8	83.8	87.9	91.9
Corps of Engineers—Civil Works	5.5	8.3	5.5	5.7	5.9	6.1	6.3
Other Defense Civil Programs	43.7	45.9	47.4	48.7	49.8	50.4	50.7
Environmental Protection Agency	8.0	7.6	7.8	8.0	8.2	8.5	8.7
Executive Office of the President	0.4	0.3	0.4	0.4	0.4	0.4	0.4
General Services Administration	0.3	0.6	0.6	0.6	0.6	0.6	0.7
International Assistance Programs	18.2	15.6	16.1	17.4	17.9	18.3	18.8
National Aeronautics and Space Administration	16.2	16.6	16.7	17.1	17.5	18.0	18.4
National Science Foundation	5.6	5.7	5.8	6.0	6.1	6.2	6.4
Office of Personnel Management	63.1	66.8	70.3	73.5	76.5	79.5	82.4
Small Business Administration	3.3	0.5	0.6	0.6	0.6	0.6	0.7
Social Security Administration	569.9	594.9	625.4	661.5	697.4	737.4	782.6
On-Budget	(54.8)	(53.0)	(55.2)	(63.4)	(66.0)	(69.2)	(78.2)
Off-Budget	(515.1)	(541.8)	(570.3)	(598.0)	(631.4)	(668.1)	(704.3)
Other Independent Agencies	17.5	19.3	24.8	22.8	23.2	23.4	24.8
On-Budget	(16.5)	(17.3)	(21.0)	(21.9)	(22.4)	(23.0)	(24.3)
Off-Budget	(1.0)	(2.0)	(3.9)	(0.9)	(0.8)	(0.4)	(0.5)
Allowances	....	....	....	....	....	....	....
Undistributed Offsetting Receipts	–226.2	–238.6	–272.3	–282.3	–290.7	–307.0	–327.2
On-Budget	(–123.4)	(–129.5)	(–154.4)	(–153.8)	(–149.4)	(–152.4)	(–157.9)
Off-Budget	(–102.8)	(–109.1)	(–117.9)	(–128.5)	(–141.2)	(–154.6)	(–169.4)
Total	**2,582.9**	**2,665.8**	**2,687.1**	**2,812.7**	**2,941.0**	**3,084.4**	**3,243.0**
On-Budget	(2,169.5)	(2,231.1)	(2,230.9)	(2,342.2)	(2,450.1)	(2,570.5)	(2,707.6)
Off-Budget	(413.4)	(434.7)	(456.2)	(470.4)	(490.9)	(513.9)	(535.5)

THE BUDGET SYSTEM AND CONCEPTS

26. THE BUDGET SYSTEM AND CONCEPTS

The budget system of the United States Government provides the means for the President and Congress to decide how much money to spend, what to spend it on, and how to raise the money they have decided to spend. Through the budget system, they determine the allocation of resources among the agencies of the Federal Government and between the Federal Government and the private sector. The budget system focuses primarily on dollars, but it also allocates other resources, such as Federal employment. The decisions made in the budget process affect the nation as a whole, State and local governments, and individual Americans. Many budget decisions have worldwide significance. The Congress and the President enact budget decisions into law. The budget system ensures that these laws are carried out.

This chapter provides an overview of the budget system and explains some of the more important budget concepts. It includes summary dollar amounts to illustrate major concepts. Other chapters of the budget documents discuss these amounts and more detailed amounts in greater depth.

The following section discusses the budget process, covering formulation of the President's budget, Congressional action, and budget execution. The next section provides information on budget coverage, including a discussion of on-budget and off-budget amounts, functional classification, how budget data is arrayed, types of funds, and full cost budgeting. Subsequent sections discuss the concepts of receipts and collections, budget authority, and outlays. These sections are followed by discussions of Federal credit; surpluses, deficits, and means of financing; Federal employment; and the basis for the budget figures. A glossary of budget terms appears at the end of the chapter.

Various laws, enacted to carry out requirements of the Constitution, govern the budget system. The chapter refers to the principal ones by title throughout the text and gives complete citations in the section just preceding the glossary.

THE BUDGET PROCESS

The budget process has three main phases, each of which is interrelated with the others:

(1) Formulation of the President's proposed budget;
(2) Congressional action on the budget; and
(3) Budget execution.

Formulation of the President's Budget

The Budget of the United States Government consists of several volumes that set forth the President's financial proposal with recommended priorities for the allocation of resources by the Government. The primary focus of the budget is on the budget year—the next fiscal year for which Congress needs to make appropriations, in this case 2007. (Fiscal year 2007 will begin on October 1, 2006 and end on September 30, 2007.) The budget also covers at least the four years following the budget year in order to reflect the effect of budget decisions over the longer term. It includes the funding levels provided for the current year, in this case 2006, so that the reader can compare the President's budget proposals to the most recently enacted levels, and it includes data on the most recently completed fiscal year, in this case 2005, so that the reader can compare budget estimates to actual accounting data.

The President begins the process of formulating the budget by establishing general budget and fiscal policy guidelines, usually by the Spring of each year, at least nine months before the President transmits the budget to Congress and at least 18 months before the fiscal year begins. (See the "Budget Calendar" below.) Based on these guidelines, the Office of Management and Budget (OMB) works with the Federal agencies to establish specific policy directions and planning levels for the agencies, both for the budget year and for at least the following four years, to guide the preparation of their budget requests.

During the formulation of the budget, the President, the Director of OMB, and other officials in the Executive Office of the President continually exchange information, proposals, and evaluations bearing on policy decisions with the Secretaries of the departments and the heads of the other Government agencies. Decisions reflected in previously enacted budgets, including the one for the fiscal year in progress, reactions to the last proposed budget (which Congress is considering when the process of preparing the upcoming budget begins), and program performance influence decisions concerning the upcoming budget. So do projections of the economic outlook, prepared jointly by the Council of Economic Advisers, OMB, and the Treasury Department.

In early Fall, agencies submit their budget requests to OMB, where analysts review them and identify issues that OMB officials need to discuss with the agencies. OMB and the agencies resolve many issues themselves. Others require the involvement of the President and White House policy officials. This decision-making process is usually completed by late December. At that time, the final stage of developing detailed budget data and the preparation of the budget documents begins.

The decision-makers must consider the effects of economic and technical assumptions on the budget estimates. Interest rates, economic growth, the rate of inflation, the unemployment rate, and the number of people eligible for various benefit programs, among other things, affect Government spending and receipts. Small changes in these assumptions can affect budget estimates by billions of dollars. (Chapter 12, "Economic Assumptions," provides more information on this subject.)

Statutory limitations on changes in receipts and outlays also influence budget decisions (see "Budget Enforcement" below).

Thus, the budget formulation process involves the simultaneous consideration of the resource needs of individual programs, the allocation of resources among the agencies and functions of the Federal Government, the total outlays and receipts that are appropriate in relation to current and prospective economic conditions, and statutory constraints.

The law governing the President's budget specifies that the President is to transmit the budget to Congress on or after the first Monday in January but not later than the first Monday in February of each year for the following fiscal year, which begins on October 1. The budget is routinely sent to Congress on the first Monday in February, giving it eight months to act on the budget before the fiscal year begins.

In some years, for various reasons, the President cannot adhere to the normal schedule. One reason is that the current law does not require an outgoing President to transmit a budget, and it is impracticable for an incoming President to complete a budget within a few days of taking office on January 20th. President Clinton, the first President subject to the current requirement, submitted a report to Congress on February 17, 1993, describing the comprehensive economic plan he proposed for the Nation and containing summary budget information. He transmitted the Budget of the United States for 1994 on April 8, 1993. President George W. Bush similarly submitted an initial document, *A Blueprint for New Beginnings—A Responsible Budget for America's Priorities*, to Congress on February 28, 2001, and transmitted the Budget of the United States Government for Fiscal Year 2002 on April 9, 2001.

In some years, the late or pending enactment of appropriations acts, other spending legislation, and tax laws considered in the previous budget cycle have delayed preparation and transmittal of complete budgets. For this reason, for example, President Reagan submitted his budget for 1988 forty-five days after the date specified in law. In other years, Presidents have submitted abbreviated budget documents on the due date, sending the more detailed documents weeks later. For example, President Clinton transmitted an abbreviated budget document to Congress on February 5, 1996, because of uncertainty over 1996 appropriations as well as possible changes in mandatory programs and tax policy. He transmitted a budget supplement and other budget volumes in March 1996.

Congressional Action [1]

Congress considers the President's budget proposals and approves, modifies, or disapproves them. It can change funding levels, eliminate programs, or add programs not requested by the President. It can add or eliminate taxes and other sources of receipts, or make other changes that affect the amount of receipts collected.

Congress does not enact a budget as such. Through the process of adopting a budget resolution (described below), it agrees on levels for total spending and receipts, the size of the deficit or surplus, and the debt limit. The budget resolution then provides the framework within which congressional committees prepare appropriations bills and other spending and receipts legislation. Congress provides spending authority for specified purposes in appropriations acts each year. It also enacts changes each year in other laws that affect spending and receipts. Both appropriations acts and these other laws are discussed in the following paragraphs.

In making appropriations, Congress does not vote on the level of outlays (spending) directly, but rather on budget authority, which is the authority provided by law to incur financial obligations that will result in outlays. In a separate process, prior to making appropriations, Congress usually enacts legislation that authorizes an agency to carry out particular programs and, in some cases, limits the amount that can be appropriated for the programs. Some authorizing legislation expires after one year, some expires after a specified number of years, and some is permanent. Congress may enact appropriations for a program even though there is no specific authorization for it.

Congress begins its work on the budget shortly after it receives the President's budget. Under the procedures established by the Congressional Budget Act of 1974, Congress decides on budget totals before completing action on individual appropriations. The Act requires each standing committee of the House and Senate to recommend budget levels and report legislative plans concerning matters within the committee's jurisdiction to the Budget Committee in each body. The Budget Committees then initiate the concurrent resolution on the budget. The budget resolution sets levels for total receipts and for budget authority and outlays, both in total and by functional category (see "Functional Classification" below). It also sets levels for the budget deficit or surplus and debt.

In the report on the budget resolution, the Budget Committees allocate the total on-budget budget authority and outlays provided in the resolution to the Appropriations Committees and the other committees that have jurisdiction over spending. (See COVERAGE OF

[1] For a fuller discussion of the congressional budget process, see Robert Keith and Allen Schick, Manual on the Federal Budget Process (Congressional Research Service Report 98–720 GOV) and Introduction to the Federal Budget Process (Congressional Research Service Report 98–721 GOV).

THE BUDGET, later in this chapter, for more information on on-budget and off-budget amounts.) The Appropriations Committees are required, in turn, to divide their allocations of budget authority and outlays among their respective subcommittees. The subcommittees may not exceed their allocations in drafting spending bills. The other committees with jurisdiction over spending and receipts may make allocations among their subcommittees but are not required to do so. The Budget Committees' reports may discuss assumptions about the level of funding for major programs. While these assumptions do not bind the other committees and subcommittees, they may influence their decisions. The budget resolution may contain "reconciliation directives" (discussed below) to the committees responsible for tax laws and for spending not controlled by annual appropriation acts, in order to conform the level of receipts and this type of spending to the levels specified in the budget resolution.

The congressional timetable calls for the whole Congress to adopt the budget resolution by April 15 of each year, but Congress regularly misses this deadline. Once Congress passes a budget resolution, a member of Congress can raise a point of order to block a bill that would exceed a committee's allocation.

Since the concurrent resolution on the budget is not a law, it does not require the President's approval. However, Congress considers the President's views in preparing budget resolutions, because legislation developed to meet congressional budget allocations does require the President's approval. In some years, the President and the joint leadership of Congress have formally agreed on plans to reduce the deficit or balance the budget. These agreements were reflected in the budget resolution and legislation passed for those years.

Once Congress approves the budget resolution, it turns its attention to enacting appropriations bills and authorizing legislation. Appropriations bills are initiated in the House. They provide the budget authority for the majority of Federal programs. The Appropriations Committee in each body has jurisdiction over annual appropriations. These committees are divided into subcommittees that hold hearings and review detailed budget justification materials prepared by the agencies within the subcommittee's jurisdiction. After a bill has been drafted by a subcommittee, the committee and the whole House, in turn, must approve the bill, usually with amendments to the original version. The House then forwards the bill to the Senate, where a similar review follows. If the Senate disagrees with the House on particular matters in the bill, which is often the case, the two bodies form a conference committee (consisting of Members of both bodies) to resolve the differences. The conference committee revises the bill and returns it to both bodies for approval. When the revised bill is agreed to, first in the House and then in the Senate, Congress sends it to the President for approval or veto.

The President can only approve or veto an entire bill; he cannot approve or veto selected parts. In 1996, Congress enacted the Line Item Veto Act, granting the President limited authority to cancel new spending and limited tax benefits when he signs laws enacted by the Congress. However, in 1998, the Supreme Court declared this authority to be unconstitutional.

For 23 of the last 25 fiscal years, including 2006, some or all of the appropriations bills were not enacted by the beginning of the year. When this occurs, Congress usually enacts a joint resolution called a "continuing resolution," which is an interim appropriations bill, to provide authority for the affected agencies to continue operations at some specified level up to a specific date or until the regular appropriations are enacted. In some years, a continuing resolution has funded a portion or all of the Government for the entire year. Congress must present these resolutions to the President for approval or veto. In some cases, Presidents have rejected continuing resolutions because they contained unacceptable provisions. Left without funds, Government agencies were required by law to shut down operations—with exceptions for some activities—until Congress passed a continuing resolution the President would approve. Shutdowns have lasted for periods of a day to several weeks.

As explained earlier, Congress also provides budget authority in laws other than appropriations acts. In fact, while annual appropriations acts control the spending for the majority of Federal programs, they control about 40 percent of the total spending in a typical year. Permanent laws, called authorizing legislation, control the rest of the spending. A distinctive feature of these laws is that they provide agencies with the authority to collect or to spend money without first requiring the Appropriations Committees to enact funding. This category of spending includes interest the Government pays on the public debt and the spending of several major programs, such as Social Security, Medicare and Medicaid, unemployment insurance, and Federal employee retirement. This chapter discusses the control of budget authority and outlays in greater detail under BUDGET AUTHORITY AND OTHER BUDGETARY RESOURCES, OBLIGATIONS, AND OUTLAYS.

Almost all taxes and most other receipts result from permanent laws. Article I, Section 7, of the Constitution provides that all bills for raising revenue shall originate in the House of Representatives. In the House, the Ways and Means Committee initiates tax bills; in the Senate, the Finance Committee has jurisdiction over tax laws.

The budget resolution often includes reconciliation directives, which require authorizing committees to change permanent laws that affect receipts and outlays. The budget resolution directs each designated committee to report amendments to the laws under the committee's jurisdiction that would achieve changes in the levels of receipts and reductions in direct spending controlled by the laws. The directives specify the dollar amount of changes that each designated committee is expected to achieve, but do not specify which laws are to be changed or the changes to be made. However, the Budget Committees' reports on the budget resolution frequently discuss assumptions about how the laws would be changed. Like other assumptions in the report, they do not bind the committees of jurisdiction but may influence their decisions. A reconciliation instruction may also specify the total amount by which the statutory limit on the public debt is to be changed.

The committees subject to reconciliation directives draft the implementing legislation. Such legislation may, for example, change the tax code, revise benefit formulas or eligibility requirements for benefit programs, or authorize Government agencies to charge fees to cover some of their costs. Congress typically enacts an omnibus budget reconciliation act, which combines the amendments to implement reconciliation directives in a single act.

Such a large and complicated bill would be difficult to enact under normal legislative procedures because it usually involves changes to tax rates or to popular social programs in order to achieve budgetary savings. The Senate considers such omnibus reconciliation acts under expedited procedures that limit total debate on the bill. As a result, there are significant restrictions with respect to the substantive content of the reconciliation measure itself, as well as amendments to the measure. Any material in the bill or amendment to the bill that is not germane, would add extraneous material, would cause deficit levels to increase, or that contains changes to the Federal Old-Age and Survivors Insurance and the Federal Disability Insurance programs are not in order under expedited reconciliation procedures.

Reconciliation acts, together with appropriations acts for the year, often implement agreements between the President and the Congress. They may include other matters, such as laws providing the means for enforcing these agreements, as described below.

Budget Enforcement

The Budget Enforcement Act (BEA), first enacted in 1990 and extended in 1993 and 1997, significantly amended the laws pertaining to the budget process, including the Congressional Budget Act, the Balanced Budget and Emergency Deficit Control Act, and the laws pertaining to the President's budget (see PRINCIPAL BUDGET LAWS, later in the chapter). The BEA constrained legislation enacted through 2002 that would increase spending or decrease spending.

The BEA divided spending into two types—***discretionary spending*** and ***direct spending***. Discretionary spending is controlled through annual appropriations acts. Direct spending, which is more commonly referred to as ***mandatory spending***, is controlled by permanent laws. However, the BEA required budget authority provided in annual appropriations acts for certain specifically identified programs to be treated as mandatory. This is because the authorizing legislation in these cases entitles beneficiaries to receive payment or otherwise obligates the Government to make payment, even though the payments are funded by a subsequent appropriation. Since the authorizing legislation effectively determines the amount of budget authority required, the BEA classified it as mandatory.

The BEA defined categories of discretionary spending and specified dollar limits known as ***caps*** on the amount of spending in each category. If the amount of budget authority or outlays provided in appropriations acts for a given year exceeded the cap for that category, the BEA required a procedure, called ***sequestration***, for reducing the spending in the category.

The BEA did not cap mandatory spending. Instead, it required that all laws that affected mandatory spending or receipts be enacted on a ***pay-as-you-go*** (PAYGO) basis. That meant that if such a law increased the deficit or reduced a surplus in the budget year or any of the four following years, another law had to be enacted with an offsetting reduction in spending or increase in receipts for each year that was affected. Otherwise, a sequestration would be triggered in the fiscal year in which the deficit would be increased.

Chapter 24, "Budget System and Concepts and Glossary," pages 460–461 in the *Analytical Perspectives* volume of the 2004 Budget, discusses the Budget Enforcement Act in more detail.

The BEA expired at the end of 2002. The Administration proposes to extend the BEA's mechanisms for limiting discretionary spending and to establish mandatory spending controls. The Administration also proposes to establish a new mechanism to measure the Federal Government's long-term unfunded obligations and to prohibit increases in those obligations. These proposals are discussed in more detail in Chapter 15, "Budget Reform Proposals," of this volume.

Budget Execution

Government agencies may not spend or obligate more than Congress has appropriated, and they may use funds only for purposes specified in law. The Antideficiency Act prohibits them from spending or obligating the Government to spend in advance of an appropriation, unless specific authority to do so has been provided in law. Additionally, the Act requires the President to apportion the budgetary resources available for most executive branch agencies. The President has delegated this authority to OMB. Some apportionments are by time periods (usually by quarter of the fiscal year), some are by projects or activities, and others are by a combination of both. Agencies may request OMB to reapportion funds during the year to accommodate changing circumstances. This system helps to ensure that funds are available to cover operations for the entire year.

During the budget execution phase, the Government sometimes finds that it needs to spend more money than Congress has appropriated for the fiscal year because of unanticipated circumstances. For example, more money might be needed to respond to a severe natural disaster. Under such circumstances, Congress may enact a supplemental appropriation.

On the other hand, the President may initiate the withholding of funds. Amounts that are withheld are apportioned as "deferred" or "withheld pending rescission" on the OMB approved apportionment form. Agencies are instructed not to withhold funds without the prior approval of OMB. When OMB approves a withholding, the Impoundment Control Act requires that the President transmit a "special message" to the Congress. The historical reason for the special message is to inform Congress that the President has unilaterally withheld funds that were enacted in regular appropriations acts. The notification allows the Congress to overturn the deferral or proposed rescission. The last time the President initiated the withholding of funds was five years ago.

By contrast, Congress often does not complete action on regular appropriations bills prior to the beginning of the fiscal year and affected agencies operate under a continuing resolution. Most continuing resolutions instruct the Administration to take the most limited funding action permitted by the CR, so as not to impinge on the final funding prerogatives of the Congress. As each regular appropriations act is subsequently enacted, the Executive Branch agencies typically adopt operating plans that allow the Congress to enact subsequent across-the-board reductions in the final appropriations act. Every year since fiscal year 2002, the Congress has consistently taken actions in appropriations acts to cancel amounts appropriated in previous laws. Typically, these subsequent reductions have been enacted in the latest or last appropriation act. Sometimes the last act has been a consolidated, omnibus, or supplemental appropriations act. For fiscal year 2006, the across-the-board reduction was included in the last enacted appropriations bill, which was the Department of Defense, Emergency Supplemental Appropriations to Address Hurricanes in the Gulf of Mexico, and Pandemic Influenza Act, 2006.

Budget Calendar

The following timetable highlights the scheduled dates for significant budget events during the year:

Between the 1st Monday in January and the 1st Monday in February	President transmits the budget.
Six weeks later	Congressional committees report budget estimates to Budget Committees.
April 15	Action to be completed on congressional budget resolution.
May 15	House consideration of annual appropriations bills may begin.
June 15	Action to be completed on reconciliation.
June 30	Action on appropriations to be completed by House.
July 15	President transmits Mid-Session Review of the Budget.
October 1	Fiscal year begins.

COVERAGE OF THE BUDGET

Federal Government and Budget Totals

Table 26–1. TOTALS FOR THE BUDGET AND THE FEDERAL GOVERNMENT

(In billions of dollars)

	2005 actual	Estimate	
		2006	2007
Budget authority			
Unified	2,583	2,758	2,739
On-budget	2,170	2,323	2,283
Off-budget	413	435	456
Receipts:			
Unified	2,154	2,285	2,416
On-budget	1,576	1,676	1,774
Off-budget	577	610	642
Outlays:			
Unified	2,472	2,709	2,770
On-budget	2,070	2,278	2,317
Off-budget	402	431	453
Surplus:			
Unified	–318	–423	–354
On-budget	–494	–602	–543
Off-budget	175	179	189

The budget documents provide information on all Federal agencies and programs. However, because the laws governing Social Security (the Federal Old-Age and Survivors Insurance and the Federal Disability Insurance trust funds) and the Postal Service Fund exclude the receipts and outlays for those activities from the budget totals and from the calculation of the deficit or surplus, the budget presents on-budget and off-budget totals. The off-budget totals include the transactions excluded by law from the budget totals. The on-budget and off-budget amounts are added together to derive the totals for the Federal Government. These are sometimes referred to as the unified or consolidated budget totals.

It is not always obvious whether a transaction or activity should be included in the budget. Where there is a question, OMB normally follows the recommendation of the 1967 President's Commission on Budget Concepts to be comprehensive of the full range of Federal agencies, programs, and activities. In recent years, for example, the budget has included the transactions of the Universal Service Fund, the Public Company

Accounting Oversight Board, Guaranty Agencies Reserves, the National Railroad Retirement Investment Trust, the United Mine Workers Combined Benefits Fund, and the Telecommunications Development Fund.

The budget includes the transactions of Electric Reliability Organizations (EROs) established pursuant to the Energy Policy Act of 2005. The Act authorizes the Federal Energy Regulatory Commission (FERC) to certify an ERO to establish and enforce reliability standards for the bulk-power system, subject to FERC review and approval. Even though the statute states that the ERO is not a department, agency, or instrumentality of the United States Government, its sources of funding and activities are governmental in nature, and its policies and operations are largely controlled by the Federal Government.

The budget also reclassifies the collections and spending by the affordable housing program (AHP) funds created by the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) as governmental and includes them in the budget totals. FIRREA requires each of the 12 Federal Home Loan Banks (FHLBs) to contribute at least 10 percent of its previous year's net earnings to an AHP fund to be used to subsidize owner-occupied and rental housing for low-income families and individuals and to provide assistance to certain first-time homebuyers. Since 1990, the FHLBs have contributed $2.4 billion to the AHP funds, of which $1.7 billion has been spent. Although the funds remain in the possession of the FHLBs, the deposit of specific amounts into the AHP funds is compulsory, and the expenditures are to meet specific governmental purposes.

In contrast, the budget excludes tribal trust funds that are owned by Indian tribes and held and managed by the Government in a fiduciary capacity on the tribes' behalf. These funds are not owned by the Government, the Government is not the source of their capital, and the Government's control is limited to the exercise of fiduciary duties. Similarly, the transactions of Government-sponsored enterprises, such as the FHLBs are not included in the on-budget or off-budget totals. Federal laws established these enterprises for public policy purposes, but they are privately owned and operated corporations. Because of their public charters, the budget discusses them and reports summary financial data in the budget Appendix and in some detailed tables.

The Appendix includes a presentation for the Board of Governors of the Federal Reserve System for information only. The amounts are not included in either the on-budget or off-budget totals because of the independent status of the System within the Government. However, the Federal Reserve System transfers its net earnings to the Treasury, and the budget records them as receipts.

Functional Classification

The functional classification arrays budget authority, outlays, and other budget data according to the major purpose served-such as agriculture, income security, and national defense. There are nineteen major functions, most of which are divided into subfunctions. For example, the Agriculture function comprises the subfunctions Farm Income Stabilization and Agricultural Research and Services. The functional array meets the Congressional Budget Act requirement for a presentation in the budget by national needs and agency missions and programs.

The following criteria are used in establishing functional categories and assigning activities to them:

- A function encompasses activities with similar purposes, emphasizing what the Federal Government seeks to accomplish rather than the means of accomplishment, the objects purchased, the clientele or geographic area served, or the Federal agency conducting the activity (except in the case of subfunction 051 in the National Defense function, which is used only for defense activities under the Department of Defense—Military).
- A function must be of continuing national importance, and the amounts attributable to it must be significant.
- Each basic unit being classified (generally the appropriation or fund account) usually is classified according to its primary purpose and assigned to only one subfunction. However, some large accounts that serve more than one major purpose are subdivided into two or more subfunctions.

Detailed functional tables, which provide information on government activities by function and subfunction, appear this year on the *Analytical Perspectives* CD ROM as Table 27.

Agencies, Accounts, Programs, Projects, and Activities

Various summary tables in the *Analytical Perspectives* volume of the budget provide information on budget authority, outlays, and offsetting collections and receipts arrayed by Federal agency. A table that lists budget authority and outlays by budget account within each agency and the totals for each agency of budget authority, outlays, and receipts that offset the agency spending totals appears this year on the *Analytical Perspectives* CD ROM as Table 28. The Appendix provides budgetary, financial, and descriptive information about programs, projects, and activities by account within each agency. The Appendix also presents the most recently enacted appropriation language for an account and any changes that are proposed to be made for the budget year.

Types of Funds

Agency activities are financed through Federal funds and trust funds.

Federal funds comprise several types of funds. Receipt accounts of the ***general fund***, which is the greater part of the budget, record receipts not earmarked by law for a specific purpose, such as income tax receipts. The general fund also includes the proceeds of general borrowing. General fund appropriation accounts record general fund expenditures. General fund appropriations draw from general fund receipts and borrowing collectively and, therefore, are not specifically linked to receipt accounts. ***Special funds*** consist of receipt accounts for Federal fund receipts that laws have earmarked for specific purposes and the associated appropriation accounts for the expenditure of those receipts. ***Public enterprise funds*** are revolving funds used for programs authorized by law to conduct a cycle of business-type operations, primarily with the public, in which outlays generate collections. ***Intragovernmental funds*** are revolving funds that conduct business-type operations primarily within and between Government agencies. The collections and the outlays of revolving funds are recorded in the same budget account.

Trust funds account for the receipt and expenditure of monies by the Government for carrying out specific purposes and programs in accordance with the terms of a statute that designates the fund as a trust fund (such as the Highway Trust Fund) or for carrying out the stipulations of a trust where the Government itself is the beneficiary (such as any of several trust funds for gifts and donations for specific purposes). ***Trust revolving funds*** are trust funds credited with collections earmarked by law to carry out a cycle of business-type operations.

The Federal budget meaning of the term "trust," as applied to trust fund accounts, differs significantly from its private sector usage. In the private sector, the beneficiary of a trust usually owns the trust's assets, which are managed by a trustee who must follow the stipulations of the trust. In contrast, the Federal Government owns the assets of most Federal trust funds, and it can raise or lower future trust fund collections and payments, or change the purposes for which the collections are used, by changing existing laws. There is no substantive difference between a trust fund and a special fund or between a trust revolving fund and a public enterprise revolving fund. The Government does act as a true trustee of assets that are owned or held for the benefit of others. For example, it maintains accounts on behalf of individual Federal employees in the Thrift Savings Fund, investing them as directed by the individual employee. The Government accounts for such funds in ***deposit funds***, which are not included in the budget. (Chapter 22, "Trust Funds and Federal Funds," provides more information on this subject.)

Budgeting for Full Costs

A budget is a financial plan for allocating resources-deciding how much the Federal Government should spend in total, program by program, and for the parts of each program and deciding how to finance the spending. The budgetary system provides a process for proposing policies, making decisions, implementing them, and reporting the results. The budget needs to measure costs accurately so that decision makers can compare the cost of a program with its benefit, the cost of one program with another, and the cost of alternative methods of reaching a specified goal. These costs need to be fully included in the budget up front, when the spending decision is made, so that executive and congressional decision makers have the information and the incentive to take the total costs into account for setting priorities.

The budget includes all types of spending, including both current operating expenditures and capital investment, and to the extent possible, both are measured on the basis of full cost. Questions are often raised about the measure of capital investment. The present budget provides policymakers the necessary information regarding investment spending. It records investment on a cash basis, and it requires Congress to provide budget authority before an agency can obligate the Government to make a cash outlay. By these means, it causes the total cost of capital investment to be compared up front in a rough and ready way with the total expected future net benefits. Since the budget measures only cost, the benefits with which these costs are compared, based on policy makers' judgment, must be presented in supplementary materials. Such a comparison of total costs with benefits is consistent with the formal method of cost-benefit analysis of capital projects in government, in which the full cost of a capital asset as the cash is paid out is compared with the full stream of future benefits (all in terms of present values). (Chapter 6 of this volume, "Federal Investment," provides more information on capital investment.)

There have been a number of proposals to change the basis for measuring capital investment in the budget. Many of these would undermine effective consideration and control of costs by spreading the real cost of the project over time and record as a current operating expense the annual depreciation for each year of an asset's life. No depreciation would be recorded until after the asset was put into service. This could be several years after the initial expenditure, in which case the budget would record no expenses at all in the budget year or several years thereafter, even though the Government is legally obligated to buy the asset, and the asset is being constructed or manufactured. Recording the annual depreciation in the budget each year would provide little control over the decision about whether to invest in the first place. Control can only be exercised up front when the Government commits itself to the full sunk cost. Spreading the costs over time would make the cost of a capital asset appear very cheap when decisions were being made that compared it to alternative expenditures. As a result, the Government would have an incentive to purchase capital assets with little regard for need, and also with little regard for the least-cost method of acquisition. Chapter 7, "Federal Investment Spending and Capital Budgeting," pages 157–165 in the *Analytical Perspectives* volume of the 2004 Budget, discusses alternative capital budget and capital expenditure presentations in more detail.

RECEIPTS, OFFSETTING COLLECTIONS, AND OFFSETTING RECEIPTS

In General

The budget records money collected by Government agencies two different ways. Depending on the nature of the activity generating the collection and the law that established the collection, they are recorded as either:

- ***Governmental receipts***, which are compared in total to outlays (net of offsetting collections and receipts) in calculating the surplus or deficit; or
- ***Offsetting collections*** or ***offsetting receipts***, which are deducted from gross outlays to calculate net outlay figures.

Governmental receipts

Governmental receipts are collections that result from the Government's exercise of its sovereign power to tax or otherwise compel payment and from gifts of money to the Government. Sometimes they are called receipts, Federal receipts, or Federal revenues. They consist mostly of individual and corporation income taxes and social insurance taxes, but also include excise taxes, compulsory user charges, regulatory fees, customs duties, court fines, certain license fees, and deposits of earnings by the Federal Reserve System. Total receipts for the Federal Government include both on-budget and off-budget receipts (see Table 26–1, "Totals for the Budget and the Federal Government," which appears earlier in this chapter.) Chapter 17, "Federal Receipts," provides more information on receipts.

Offsetting Collections and Offsetting Receipts

Offsetting collections and offsetting receipts are recorded as offsets to (deductions from) spending, not as additions on the receipt side of the budget. As explained below, they are recorded as offsets to spending so that the budget totals represent governmental rather than market activity and reflect the Government's net transactions with the public. They are recorded in one of two ways, based on interpretation of laws and longstanding budget concepts and practice. They are offsetting collections when the collections are authorized by law to be credited to expenditure accounts. Otherwise, they are deposited in receipt accounts and called offsetting receipts.

Offsetting collections and offsetting receipts result from one of the following types of transactions:

- ***Business-like transactions or market-oriented activities with the public***—collections from the public in exchange for goods or services, such as the proceeds from the sale of postage stamps, the fees charged for admittance to recreation areas, and the proceeds from the sale of Government-owned land. The budget records these amounts as *offsetting collections from non-Federal sources* (for offsetting collections) or as *proprietary receipts* (for offsetting receipts). The amounts are deducted from gross budget authority and outlays, rather than added to receipts. This treatment produces budget totals for receipts, budget authority, and outlays that represent governmental rather than market activity.
- ***Intragovernmental transactions***—collections from other Federal Government accounts. The budget records collections by one Government account from another as *offsetting collections from Federal sources* (for offsetting collections) or as *intragovernmental receipts* (for offsetting receipts). For example, the General Services Administration rents office space to other Government agencies and records their rental payments as offsetting collections from Federal sources in the Federal Buildings Fund. These transactions are exactly offsetting and do not affect the surplus or deficit. However, they are an important accounting mechanism for allocating costs to the programs and activities that cause the Government to incur the costs. Intragovernmental offsetting collections and receipts are deducted from gross budget authority and outlays so that the budget totals measure the transactions of the Government with the public.
- ***Offsetting governmental transactions***—collections from the public that are governmental in nature (e.g., tax receipts, regulatory fees, compulsory user charges, custom duties, license fees) but required by law to be misclassified as offsetting. The budget records amounts from non-Federal sources that are governmental in nature as *offsetting governmental collections* (for offsetting collections) or as *offsetting governmental receipts* (for offsetting receipts).

A table in Chapter 21 of this volume, "Outlays to the Public, Gross and Net," shows the effect of offsetting collections and receipts on gross outlays for each major Federal agency.

Offsetting Collections

Some laws authorize agencies to credit collections directly to the account from which they will be spent and, usually, to spend the collections for the purpose of the account without further action by Congress. Most revolving funds operate with such authority. For example, a permanent law authorizes the Postal Service to use collections from the sale of stamps to finance its operations without a requirement for annual appropriations. The budget records these collections in the Postal Service Fund (a revolving fund) and records budget authority in an amount equal to the collections. In addition to revolving funds, some agencies are authorized to charge fees to defray a portion of costs for a program that are otherwise financed by appropriations from the general fund and usually to spend the collections without further action by Congress. In such cases, the budget records the offsetting collections and resulting budget authority in the program's general fund expenditure account. Similarly, intragovernmental collections authorized by some laws may be recorded as offsetting collections and budget authority in revolving funds or in general fund expenditure accounts.

Sometimes appropriations acts or provisions in other laws limit the obligations that can be financed by offsetting collections. In those cases, the budget records budget authority in the amount available to incur obligations, not in the amount of the collections.

Offsetting collections credited to expenditure accounts automatically offset the outlays at the expenditure account level. Where accounts have offsetting collections, the budget shows the budget authority and outlays of the account both gross (before deducting offsetting collections) and net (after deducting offsetting collections). Totals for the agency, subfunction, and budget are net of offsetting collections.

Offsetting Receipts

Collections that are offset against gross outlays but are not authorized to be credited to expenditure accounts are credited to receipt accounts and are called offsetting receipts. Offsetting receipts are deducted from budget authority and outlays in arriving at total budget authority and outlays. However, unlike offsetting collections credited to expenditure accounts, offsetting receipts do not offset budget authority and outlays at the account level. In most cases, they offset budget authority and outlays at the agency and subfunction levels.

Proprietary receipts from a few sources, however, are not offset against any specific agency or function and are classified as undistributed offsetting receipts. They are deducted from the Government-wide totals for budget authority and outlays. For example, the collections of rents and royalties from outer continental shelf lands are undistributed because the amounts are large and for the most part are not related to the spending of the agency that administers the transactions and the subfunction that records the administrative expenses.

Similarly, two kinds of intragovernmental transactions—agencies' payments as employers into Federal employee retirement trust funds and interest received by trust funds—are classified as undistributed offsetting receipts. They appear instead as special deductions in computing total budget authority and outlays for the Government rather than as offsets at the agency level. This special treatment is necessary because the amounts are large and would distort measures of the agency's activities if they were attributed to the agency.

User Charges

User charges are fees assessed on individuals or organizations for the provision of Government services and for the sale or use of Government goods or resources. The payers of the user charge must be limited in the authorizing legislation to those receiving special benefits from, or subject to regulation by, the program or activity beyond the benefits received by the general public or broad segments of the public (such as those who pay income taxes or customs duties). Policy regarding user charges is established in OMB Circular A-25, "User Charges" (July 8, 1993). The term encompasses proceeds from the sale or use of government goods and services, including the sale of natural resources (such as timber, oil, and minerals) and proceeds from asset sales (such as property, plant, and equipment). User charges are not necessarily earmarked for the activity they finance and may be credited to the general fund of the Treasury.

The term "user charge" does not refer to a separate budget category for collections. User charges are classified in the budget as receipts, offsetting receipts, or offsetting collections according to the principles explained above.

See Chapter 18, "User Charges and Other Collections," for more information on the classification of user charges.

BUDGET AUTHORITY AND OTHER BUDGETARY RESOURCES, OBLIGATIONS, AND OUTLAYS

Budget authority, obligations, and outlays are the primary benchmarks and measures of the budget control system. Congress enacts laws that provide agencies with spending authority in the form of budget authority. Before agencies can use the resources, OMB must approve their spending plans. After the plans are approved, agencies can enter into binding agreements to purchase items or services or to make grants or other payments. These agreements are recorded as obligations of the United States and deducted from the amount of budgetary resources available to the agency. When payments are made, the obligations are liquidated and outlays recorded. These concepts are discussed more fully below.

Budget Authority and Other Budgetary Resources

Budget authority is the authority provided in law to enter into legal obligations that will result in immediate or future outlays of the Government. In other words, it is the amount of money that agencies are allowed to commit to be spent in current or future years. Government officials may obligate the Government to make outlays only to the extent they have been granted budget authority.

The budget records new budget authority as a dollar amount in the year when it first becomes available. When permitted by law, unobligated balances of budget authority may be carried over and used in the next year. The budget does not record these balances as budget authority again. They do, however, constitute a budgetary resource that is available for obligation. In some cases, a provision of law (such as a limitation on obligations or a benefit formula) precludes the obligation of funds that would otherwise be available for obligation. In such cases, the budget records budget authority equal to the amount of obligations that can be incurred. A major exception to this rule is for the highway and mass transit programs financed by the Highway Trust Fund, where budget authority is measured as the amount of contract authority (described below) provided in authorizing statutes, even though the obligation limitations enacted in annual appropriations acts restrict the amount of contract authority that can be obligated.

In deciding the amount of budget authority to request for a program, project, or activity, agency officials estimate the total amount of obligations they will need to incur to achieve desired goals and subtract the unobligated balances available for these purposes. The amount of budget authority requested is influenced by the nature of the programs, projects, or activities being financed. For current operating expenditures, the amount requested usually covers the needs for the year. For major procurement programs and construction projects, agencies generally must request sufficient budget authority in the first year to fully fund an economically useful segment of a procurement or project, even though it may be obligated over several years. This full funding policy is intended to ensure that the decision-makers take into account all costs and benefits fully at the time decisions are made to provide resources. It also avoids sinking money into a procurement or project without being certain if or when future funding will be available to complete the procurement or project.

Budget authority takes several forms:

- ***Appropriations***, provided in annual appropriations acts or permanent laws, permit agencies to incur obligations and make payment;
- ***Borrowing authority***, usually provided in permanent laws, permits agencies to incur obligations but requires them to borrow funds, usually from the general fund of the Treasury, to make payment;
- ***Contract authority***, usually provided in permanent law, permits agencies to incur obligations in advance of a separate appropriation of the cash for payment or in anticipation of the collection of receipts that can be used for payment; and
- ***Spending authority from offsetting collections***, usually provided in permanent law, permits agencies to credit offsetting collections to an expenditure account, incur obligations, and make payment using the offsetting collections.

Because offsetting collections and receipts are deducted from gross budget authority, they are referred to as negative budget authority for some purposes, such as Congressional Budget Act provisions that pertain to budget authority.

Authorizing statutes usually determine the form of budget authority for a program. The authorizing statute may authorize a particular type of budget authority to be provided in annual appropriations acts, or it may provide one of the forms of budget authority directly, without the need for further appropriations.

An appropriation may make funds available from the general fund, special funds, or trust funds, or authorize the spending of offsetting collections credited to expenditure accounts, including revolving funds. Borrowing authority is usually authorized for business-like activities where the activity being financed is expected to produce income over time with which to repay the borrowing with interest. The use of contract authority is traditionally limited to transportation programs.

New budget authority for most Federal programs is normally provided in annually enacted appropriations acts. However, new budget authority for more than half of all outlays is made available through permanent appropriations under existing laws and does not require current action by Congress. Much of the permanent budget authority is for trust funds, interest on the public debt, and the authority to spend offsetting collections credited to appropriation or fund accounts. For most trust funds, the budget authority is automatically appropriated under existing law from the available balance of their receipts and equals the estimated annual obligations of the funds. For interest on the public debt, budget authority is automatically provided under a permanent appropriation enacted in 1847 and equals interest outlays.

Annual appropriations acts generally make budget authority available for obligation only during the fiscal year to which the act applies. However, they frequently allow budget authority for a particular purpose to remain available for obligation for a longer period or indefinitely (that is, until expended or until the program objectives have been attained). Typically, budget authority for current operations is made available for only one year, and budget authority for construction and some research projects is available for a specified number of years or indefinitely. Budget authority provided in authorizing statutes, such as for most trust funds, is available indefinitely. Only another law can extend a limited period of availability (see “Reappropriation” below).

Budget authority that is available for more than one year and not obligated in the year it becomes available is carried forward for obligation in a following year. In some cases, an account may carry forward unobligated budget authority from more than one year. The sum of such amounts constitutes the account’s ***unobligated balance***. Most of this budget authority is earmarked for specific uses and is not available for new programs. A small part may never by obligated or spent, primarily amounts provided for contingencies that do not occur or reserves that never have to be used.

Budget authority that has been obligated but not paid constitutes the account’s ***unpaid obligations***. For example, in the case of salaries and wages, one to three weeks elapse between the time of obligation and the time of payment. In the case of major procurement and construction, payments may occur over a period of several years after the obligation is made. Unpaid obligations net of the accounts receivable and unfilled customers orders are defined by law as the ***obligated balances***. Obligated balances of budget authority at the end of the year are carried forward until the obligations are paid or the balances are canceled. (A general law cancels the obligated balances of budget authority that was made available for a definite period five years after the end of the period, and then other resources must be used to pay the obligations.) Due to such flows, a change in the amount of budget authority available in any one year may change the level of obligations and outlays for several years to come. Conversely, a change in the amount of obligations incurred from one year to the next does not necessarily result from an equal change in the amount of budget authority available for that year and will not necessarily result in an equal change in the level of outlays in that year.[2]

Congress usually makes budget authority available on the first day of the fiscal year for which the appropriations act is passed. Occasionally, the appropriations language specifies a different timing. The language may provide an ***advance appropriation***—budget authority that does not become available until one year or more beyond the fiscal year for which the appropriations act is passed. ***Forward funding*** is budget authority that is made available for obligation beginning in the last quarter of the fiscal year (beginning on July 1st) for the financing of ongoing grant programs during the next fiscal year. This kind of funding is used mostly for education programs, so that obligations for grants can be made prior to the beginning of the next school year. For certain benefit programs funded by annual appropriations, the appropriation provides for ***advance funding***—budget authority that is to be charged to the appropriation in the succeeding year but which authorizes obligations to be incurred in the last quarter of the current fiscal year if necessary to meet benefit payments in excess of the specific amount appropriated for the year. When such authority is used, an adjustment is made to increase the budget authority for the fiscal year in which it is used and to reduce the budget authority of the succeeding fiscal year.

Provisions of law that extend the availability of unobligated amounts that have expired or would otherwise expire are called ***reappropriations***. Reappropriations of expired balances that are newly available for obligation in the current or budget year count as new budget authority in the fiscal year in which the balances become newly available. For example, if a 2006 appropriations act extends the availability of unobligated budget authority that expired at the end of 2005, new budget authority would be recorded for 2006.

For purposes of the Budget Enforcement Act (discussed earlier under "Budget Enforcement"), the budget classifies budget authority as ***discretionary*** or ***mandatory***. This classification indicates whether appropriations acts or authorizing legislation control the amount of budget authority that is available. Generally, budget authority is discretionary if provided in an annual appropriations act and mandatory if provided in authorizing legislation. However, the BEA requires the budget authority provided in annual appropriations acts for certain specifically identified programs to be classified as mandatory. This is because the authorizing legislation for these programs entitles beneficiaries to receive payment or otherwise obligates the Government to make payment and effectively determines the amount of budget authority required, even though the payments are funded by a subsequent appropriation. Sometimes, budget authority is characterized as current or permanent. Current authority requires congressional appropriations action on the request for new budget authority for the year involved. Permanent authority becomes available pursuant to standing provisions of law without further appropriations action by Congress after transmittal of the budget for the year involved. Generally, budget authority is current if an annual appropriations act provides it and permanent if authorizing legislation provides it. By and large, the current/permanent distinction has been replaced by the discretionary/mandatory distinction, which is similar, but not identical. Outlays are also classified as ***discretionary*** or ***mandatory*** according to the classification of the budget authority from which they flow (see "Outlays" below).

The amount of budget authority recorded in the budget depends on whether the law provides a specific amount or specifies a variable factor that determines the amount. It is considered ***definite*** if the law specifies a dollar amount (which may be an amount not to be exceeded). It is considered ***indefinite*** if, instead of specifying an amount, the law permits the amount to be determined by subsequent circumstances. For example, indefinite budget authority is provided for interest on the public debt, payment of claims and judgments awarded by the courts against the U.S. and many entitlement programs. Many of the laws that authorize collections to be credited to revolving, special, and trust funds make all of the collections available for expenditure for the authorized purposes of the fund, and such authority is considered to be indefinite budget authority.

Obligations Incurred

Following the enactment of budget authority and the completion of required apportionment action, Government agencies incur obligations to make payments (see earlier discussion under "Budget Execution"). Agencies must record obligations when they enter into binding agreements that will result in immediate or future outlays. Such obligations include the current liabilities for salaries, wages, and interest; and contracts for the purchase of supplies and equipment, construction, and the acquisition of office space, buildings, and land. For Federal credit programs, obligations are recorded in an amount equal to the estimated subsidy cost of direct loans and loan guarantees (see FEDERAL CREDIT below).

[2] A separate report, "Balances of Budget Authority," provides additional information on balances. The National Technical Information Service, Department of Commerce makes the report available shortly after the budget is transmitted.

Outlays

Outlays are the measure of Government spending. They are payments that liquidate obligations (other than the repayment of debt). The budget records them when obligations are paid, in the amount that is paid.

Agency, function and subfunction, and Government-wide outlay totals are stated net of offsetting collections and offsetting receipts for most budget presentations. (Offsetting receipts from a few sources do not offset any specific function, subfunction, or agency, as explained previously, but only offset Government-wide totals.) Outlay totals for accounts with offsetting collections are stated both gross and net of the offsetting collections credited to the account. However, the outlay totals for special and trust funds with offsetting receipts are not stated net of the offsetting receipts.

The Government usually makes outlays in the form of cash (currency, checks, or electronic fund transfers). However, in some cases agencies pay obligations without disbursing cash and the budget records outlays nevertheless for the equivalent method. For example, the budget records outlays for the full amount of Federal employees' salaries, even though the cash disbursed to employees is net of Federal and state income taxes withheld, retirement contributions, life and health insurance premiums, and other deductions. (The budget also records receipts for the deductions of Federal income taxes and other payments to the Government.) When debt instruments (bonds, debentures, notes, or monetary credits) are used in place of cash to pay obligations, the budget records outlays financed by an increase in agency debt. For example, the budget records the acquisition of physical assets through certain types of lease-purchase arrangements as though a cash disbursement were made for an outright purchase. The transaction creates a Government debt, and the cash lease payments are treated as repayments of principal and interest.

The measurement of interest varies. The budget records outlays for the interest on the public issues of Treasury debt securities as the interest accrues, not when the cash is paid. A small portion of this debt consists of inflation-indexed securities, which feature monthly adjustments to principal for inflation and semiannual payments of interest on the inflation-adjusted principal. As with fixed-rate securities, the budget records interest outlays as the interest accrues. The monthly adjustment to principal is recorded, simultaneously, as an increase in debt outstanding and an outlay of interest.

Most Treasury debt securities held by trust funds and other Government accounts are in the Government account series (special issues). The budget normally states the interest on these securities on a cash basis. When a Government account is invested in Federal debt securities, the purchase price is usually close or identical to the par (face) value of the security. The budget records the investment at par value and adjusts the interest paid by Treasury and collected by the account by the difference between purchase price and par, if any. However, two trust funds in the Department of Defense, the Military Retirement Trust Fund and the Education Benefits Trust Fund, routinely have relatively large differences between purchase price and par. For these funds, the budget records the holdings of debt at par but records the differences between purchase price and par as adjustments to the assets of the funds that are amortized over the life of the security. The budget records interest as the amortization occurs.

For Federal credit programs, outlays are equal to the subsidy cost of direct loans and loan guarantees and are recorded as the underlying loans are disbursed (see FEDERAL CREDIT below).

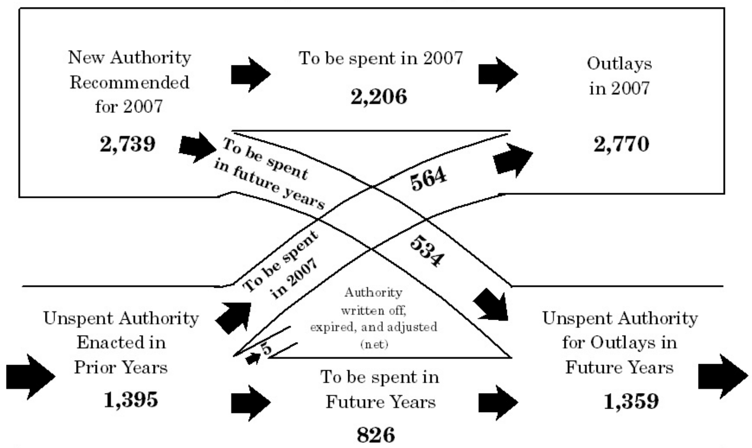
The budget records refunds of receipts that result from overpayments (such as income taxes withheld in excess of tax liabilities) as reductions of receipts, rather than as outlays. However, the budget records payments to taxpayers for refundable tax credits (such as earned income tax credits) that exceed the taxpayer's tax liability as outlays. Refunds of overpayments by the Government are recorded as offsetting collections or offsetting receipts.

Not all of the new budget authority for 2007 will be obligated or spent in 2007. Outlays during a fiscal year may liquidate obligations incurred in the same year or in prior years. Obligations, in turn, may be incurred against budget authority provided in the same year or against unobligated balances of budget authority provided in prior years. Outlays, therefore, flow in part from budget authority provided for the year in which the money is spent and in part from budget authority provided in prior years. The ratio of a given year's outlays resulting from budget authority enacted in that or a prior year to the original amount of that budget authority is referred to as the spendout rate for that year.

As shown in the following chart, $2,206 billion of outlays in 2007 (80 percent of the outlay total) will be made from that year's $2,739 billion total of proposed new budget authority (a first-year spendout rate of 81 percent). Thus, the remaining $564 billion of outlays in 2007 (20 percent of the outlay total) will be made from budget authority enacted in previous years. At the same time, $534 billion of the new budget authority proposed for 2007 (19 percent of the total amount proposed) will not lead to outlays until future years. In general, the total budget authority for a particular year is not directly indicative of that year's outlays since it combines various types of budget authority that have different short-term and long-term implications for budget obligations and outlays.

Chart 26-1. Relationship of Budget Authority to Outlays for 2007

(Billions of dollars)



As described earlier, the budget classifies budget authority and outlays as discretionary or mandatory for the purposes of the BEA. This classification of outlays measures the extent to which actual spending is controlled through the annual appropriations process. Typically, only one-third ($968 billion in 2005) of total outlays for a fiscal year are discretionary and the remaining two-thirds ($1,504 billion in 2005) are mandatory spending and net interest. Such a large portion of total spending is nondiscretionary because authorizing legislation determines net interest ($184 billion in 2005) and the spending for a few programs with large amounts of spending each year, such as Social Security ($519 billion in 2005) and Medicare ($294 billion in 2005).

The bulk of mandatory outlays flows from an equal amount of budget authority recorded in the same fiscal year. This is not the case for discretionary budget authority and outlays. For most major construction and procurement projects and long-term contracts, for example, the budget authority covers the entire cost estimated when the projects are initiated even though the work will take place and outlays will be made over a period extending beyond the year for which the budget authority is enacted. Similarly, discretionary budget authority for most education and job training activities is appropriated for school or program years that begin in the fourth quarter of the fiscal year. Most of these funds result in outlays in the year after the appropriation.

FEDERAL CREDIT

Some Government programs make direct loans or loan guarantees. A ***direct loan*** is a disbursement of funds by the Government to a non-Federal borrower under a contract that requires repayment of such funds with or without interest. The term includes equivalent transactions such as selling a property on credit terms in lieu of receiving cash up front. A ***loan guarantee*** is any guarantee, insurance, or other pledge with respect to the payment of all or a part of the principal or interest on any debt obligation of a non-Federal borrower to a non-Federal lender. The Federal Credit Reform Act (FCRA) prescribes the budget treatment for Federal credit programs. Under this treatment, the budget records the net cost to the Government (subsidy cost) when the loans are disbursed, rather than the cash flows year-by-year over the term of the loan, so direct loans and loan guarantees can be compared to each other and to other methods of delivering benefits, such as grants, on an equivalent basis.

The cost of direct loans and loan guarantees, sometimes called the "subsidy cost," is estimated as the present value of expected disbursements over the term of the loan less the present value of expected collections.[3] As for most other kinds of programs, agencies can make loans or guarantee loans only if Congress has appropriated funds sufficient to cover the subsidy costs or provided a limitation on the amount of direct loans or loan guarantees that can be made in annual appropriations acts.

The budget records the estimated long-term cost to the Government arising from direct loans and loan

[3] Present value is a standard financial concept that allows for the time value of money, that is, for the fact that a given sum of money is worth more at present than in the future because interest can be earned on it.

guarantees in ***credit program accounts***. When a Federal agency disburses a direct loan or when a non-Federal lender disburses a loan guaranteed by a Federal agency, the program account outlays an amount equal to the cost to a non-budgetary ***credit financing account***. The financing accounts record the actual transactions with the public. For a few programs, the estimated cost is negative, because the present value of expected collections exceeds the present value of expected disbursements over the term of the loan. In such cases, the financing account makes a payment to the program's receipt account, where it is recorded as an offsetting receipt. In a few cases, the receipts are earmarked in a special fund established for the program and are available for appropriation for the program.

The agencies responsible for credit programs must reestimate the cost of the outstanding direct loans and loan guarantees each year. If the estimated cost increases, the program account makes an additional payment to the financing account. If the estimated cost decreases, the financing account makes a payment to the program's receipt account, where it is recorded as an offsetting receipt. The FCRA provides permanent indefinite appropriations to pay for upward reestimates.

If the Government modifies the terms of an outstanding direct loan or loan guarantee in a way that increases the cost, as the result of a law or the exercise of administrative discretion under existing law, the program account records obligations for an additional amount equal to the increased cost and outlays the amount to the financing account. As with the original cost, agencies may incur modification costs only if Congress has appropriated funds to cover them. A modification may also reduce costs, in which case the financing account makes a payment to the program's receipt account.

Credit financing accounts record all cash flows to and from the Government arising from direct loan obligations and loan guarantee commitments. These cash flows consist mainly of direct loan disbursements and repayments, loan guarantee default payments, fees and interest from the public, the receipt of subsidy cost payments from program accounts, and interest paid to or received from Treasury. Separate financing accounts record the cash flows of direct loans and of loan guarantees for programs that provide both types of credit. The budget totals exclude the transactions of financing accounts because they are not a cost to the Government. However, since financing accounts record cash flows to and from the Government, they affect the means of financing a budget surplus or deficit (see "Credit Financing Accounts" in the next section). The budget documents display the transactions of the financing accounts, together with the related program accounts, for information and analytical purposes.

The FCRA, which was enacted in 1990, grandfathered direct loan obligations and loan guarantee commitments made prior to 1992. The budget records these on a cash basis in ***credit liquidating accounts***, the same as they were recorded before FCRA was enacted. However, this exception ceases to apply if the direct loans or loan guarantees are modified as described above. In that case, the budget records a modification subsidy cost or savings, as appropriate, and begins to account for the associated transactions as the FCRA prescribes for direct loan obligations and loan guarantee commitments made in 1992 or later.

BUDGET DEFICIT OR SURPLUS AND MEANS OF FINANCING

When outlays exceed receipts, the difference is a deficit, which the Government finances primarily by borrowing. When receipts exceed outlays, the difference is a surplus, and the Government uses the surplus primarily to reduce debt. The Government's debt (debt held by the public) is approximately the cumulative amount of borrowing to finance deficits, less repayments from surpluses. Borrowing is not exactly equal to the deficit, and debt repayment is not exactly equal to the surplus, because of the other means of financing such as those discussed under this heading. Some, such as the net disbursements of the direct loan financing accounts, normally increase the Government's borrowing needs or decrease its ability to repay debt; others, such as the loan guarantee financing accounts, normally have the opposite effect or may be either positive or negative. In some years, such as 2003, the net effect of the other means of financing is minor relative to the borrowing or debt repayment; in other years, such as 2002, the net effect may be significant.

Borrowing and Debt Repayment

The budget treats borrowing and debt repayment as a means of financing, not as receipts and outlays. If borrowing were defined as receipts and debt repayment as outlays, the budget would be virtually balanced by definition. This rule applies both to borrowing in the form of Treasury securities and to specialized borrowing in the form of agency securities (including the issuance of debt securities to liquidate an obligation and the sale of certificates representing participation in a pool of loans).

Two alternative financing methods employed by the Tennessee Valley Authority (TVA) to finance the acquisition of TVA assets are considered to be agency debt. The budget records the cash proceeds from a contract to lease some recently-constructed power generators to private investors and simultaneously lease them back and the cash proceeds from prepayments for power that TVA sells to its power distributors as a type of borrowing from the public. These transactions are discussed in more detail in Chapter 16 of this volume, "Federal Borrowing and Debt."

In 2005, the Government borrowed $297 billion from the public. This financed nearly all of the $318 billion deficit in that year. The rest of the deficit was financed by the net effect of the other means of financing, such as changes in cash balances and other accounts discussed below. At the end of 2005, the debt held by the public was $4,592 billion.

In addition to selling debt to the public, the Treasury Department issues debt to Government accounts, primarily trust funds that are required by law to invest in Treasury securities. Issuing and redeeming this debt does not affect the means of financing, because these transactions occur between one Government account and another and thus do not raise or use any cash for the Government as a whole.

(See Chapter 16 of this volume, "Federal Borrowing and Debt," for a fuller discussion of this topic.)

Debt Buyback Premiums

From 2000 through April 2002, the Treasury Department bought back outstanding U.S. Treasury bonds as part of its efforts to manage efficiently the publicly held debt. Because interest rates were lower than the coupon rates on the bonds that Treasury bought back, the government had to pay a premium over the book value of these securities. This buyback premium was recorded as a means of financing, not as outlays. Chapter 24, "Budget System and Concepts and Glossary," pages 457–458 in the *Analytical Perspectives* volume of the 2001 Budget, discusses the basis for this treatment in more detail, including an examination of the alternatives that were considered.

Exercise of Monetary Power

Seigniorage is the profit from coining money. It is the difference between the value of coins as money and their cost of production. Seigniorage adds to the Government's cash balance, but unlike the payment of taxes or other receipts, it does not involve a transfer of financial assets from the public. Instead, it arises from the exercise of the Government's power to create money and the public's desire to hold financial assets in the form of coins. Therefore, the budget excludes seigniorage from receipts and treats it as a means of financing other than borrowing from the public. The budget also treats profits resulting from the sale of gold as a means of financing, since the value of gold is determined by its value as a monetary asset rather than as a commodity.

Credit Financing Accounts

The budget records the net cash flows of credit programs in credit financing accounts. They are excluded from the budget because they are not allocations of resources by the Government (see FEDERAL CREDIT above). However, even though they do not affect the surplus or deficit, they can either increase or decrease the Government's need to borrow. Therefore, they are recorded as a means of financing.

Financing account disbursements to the public increase the requirement for Treasury borrowing in the same way as an increase in budget outlays. Financing account receipts from the public can be used to finance the payment of the Government's obligations and therefore reduce the requirement for Treasury borrowing from the public in the same way as an increase in budget receipts.

Deposit Fund Account Balances

The Treasury uses non-budgetary accounts, called deposit funds, to record cash held temporarily until ownership is determined (for example, earnest money paid by bidders for mineral leases) or cash held by the Government as agent for others (for example, State and local income taxes withheld from Federal employees' salaries and not yet paid to the State or local government or the Thrift Savings Fund, a defined contribution pension fund held and managed in a fiduciary capacity by the Government). Deposit fund balances may be held in the form of either invested or uninvested balances. To the extent that they are not invested, changes in the balances are available to finance expenditures and are recorded as a means of financing other than borrowing from the public. To the extent that they are invested in Federal debt, changes in the balances are reflected as borrowing from the public in lieu of borrowing from other parts of the public and are not reflected as a separate means of financing.

Exchanges with the International Monetary Fund (IMF)

Under the terms of its participation in the IMF, the U.S. transfers dollars to the IMF and receives Special Drawing Rights (SDR's) in return. The SDR's are interest-bearing monetary assets and may be exchanged for foreign currency at any time. These transfers are like bank deposits and withdrawals, where the government exchanges one type of financial asset (cash) for another (bank deposit), with no change in total financial assets. Following a recommendation of the 1967 President's Commission on Budget Concepts, the budget excludes these transfers from budget outlays or receipts. In contrast, the budget records interest paid by the IMF on U.S. deposits as an offsetting receipt in the general fund of the Treasury. It also records outlays for foreign currency exchanges to the extent there is a realized loss in dollars terms and offsetting receipts to the extent there is a realized gain in dollar terms.

Railroad Retirement Board Investments

Under longstanding rules, the budget treats investments in non-Federal securities as a purchase of an asset, recording an obligation and an outlay in an amount equal to the purchase price in the year of the purchase. Since investments in non-Federal securities consume cash, fund balances (of funds available for obligation) normally exclude the value of non-Federal securities. However, the Railroad Retirement and Survivors' Improvement Act of 2001 (Public Law 107–90) requires purchases or sales of non-Federal assets by the National Railroad Retirement Investment Trust to be treated as a means of financing in the budget.

Earnings on investments by the National Railroad Retirement Investment Trust in private assets pose special challenges for budget projections. Equities and private bonds earn a higher return on average than the Treasury rate, but that return is subject to greater uncertainty. Sound budgeting principles require that estimates of future trust fund balances reflect both the average return and the cost of risk associated with the uncertainty of that return. (The latter is particularly true in cases where individual beneficiaries have not made a voluntary choice to assume additional risk.) Estimating both of these separately is quite difficult. While the additional returns that these assets have received in the past are known, it is quite possible that these premiums will differ in the future. Furthermore, there is no existing procedure for the budget to record separately the cost of risk from such an investment, even if it could be estimated accurately. Economic theory suggests, however, that the difference between the expected return of a risky liquid asset and the Treasury rate is equal to the cost of the asset's additional risk as priced by the market. Following through on this insight, the best way to project the rate of return on the Fund's balances is to use a Treasury rate. This will mean that assets with equal economic value as measured by market prices will be treated equivalently, avoiding the appearance that the budget could benefit if the Government bought private sector assets.

The actual and estimated returns to private securities are recorded in subfunction 909, other investment income. The actual year returns include interest, dividends, and capital gains and losses on private equities and other securities. The Fund's portfolio of these assets is revalued at market prices at the end of the actual year to determine capital gains or losses. As a result, the Fund's end-of-year balance reflects the current market value of resources available to the Government to finance benefits. Earnings for the current and future years are estimated using the 10-year Treasury rate and the value of the Fund's portfolio at the end of the actual year. No estimates are made of gains and losses for the current year or subsequent years.

FEDERAL EMPLOYMENT

The budget includes information on civilian and military employment. It also includes information on related personnel compensation and benefits and on staffing requirements at overseas missions. Chapter 24 of this volume, "Federal Employment and Compensation," provides two different measures of Federal employment levels-actual positions filled and full-time equivalents (FTE). Agency FTEs are the measure of the total number of hours worked by an agency's Federal employees divided by the total number of workhours in one fiscal year. In the budget Appendix, only the FTE measure is used because it takes into account part-time employment, temporary employment, and vacancies during the year.

BASIS FOR BUDGET FIGURES

Data for the Past Year

The past year column (2005) generally presents the actual transactions and balances as recorded in agency accounts and as summarized in the central financial reports prepared by the Treasury Department for the most recently completed fiscal year. Occasionally the budget reports corrections to data reported erroneously to Treasury but not discovered in time to be reflected in Treasury's published data. In addition, in certain cases the Budget has a broader scope and includes financial transactions that are not reported to Treasury (see Chapter 20 of this volume, "Comparison of Actual to Estimated Totals," for a summary of these differences).

Data for the Current Year

The current year column (2006) includes estimates of transactions and balances based on the amounts of budgetary resources that were available when the budget was transmitted, including amounts appropriated for the year. The current year estimates also assume enactment of S. 1932, the Deficit Reduction Act, which was pending in the Congress at the time the budget was prepared.

Data for the Budget Year

The budget year column (2006) includes estimates of transactions and balances based on the amounts of budgetary resources that are estimated to be available, including new budget authority requested under current authorizing legislation, and amounts estimated to result from changes in authorizing legislation and tax laws.

The budget Appendix generally includes the appropriations language for the amounts proposed to be appropriated under current authorizing legislation. In a few cases, this language is transmitted later because the exact requirements are unknown when the budget is transmitted. The Appendix generally does not include appropriations language for the amounts that will be requested under proposed legislation; that language is usually transmitted later, after the legislation is enacted. Some tables in the budget identify the items for later transmittal and the related outlays separately. Estimates of the total requirements for the budget year include both the amounts requested with the transmittal of the budget and the amounts planned for later transmittal.

Data for the Outyears

The budget presents estimates for each of the four years beyond the budget year (2008 through 2011) in order to reflect the effect of budget decisions on longer term objectives and plans.

Classification of Tricare Accruals

Section 725 of the Ronald W. Reagan National Defense Authorization Act for Fiscal Year 2005 (P.L. No. 108–375) changed the Department of Defense contributions to the Department of Defense Medicare-Eligible Retiree Health Care Fund (the Retiree Health Care Fund) for the cost of Tricare benefits earned by active duty service members beginning in 2006. The Act replaced annual appropriations to the military personnel accounts of the Department of Defense with permanent, indefinite appropriations from the General Fund. The Tricare accrual payments are classified within the National Defense function as discretionary.

The Act created the same funding structure for the Tricare benefits earned by uniformed service members of the Coast Guard, the National Oceanic and Atmospheric Administration, and the Public Health Service. Each agency's contribution to the Retiree Health Care Fund for the accruing Tricare benefits of its employees is comparable to the treatment of the Department of Defense contribution for DoD uniformed service members. Beginning in 2006, the contribution is funded by permanent, indefinite authority for each agency. The payments are classified as discretionary and in the same subfunction as the previous annually-funded contributions.

Chapter 26, "The Budget System and Concepts," pages 422–425 in the *Analytical Perspectives* volume of the 2006 Budget, discusses the classification of Tricare Accruals in greater detail.

Allowances

The budget may include lump-sum allowances to cover certain transactions that are expected to increase or decrease budget authority, outlays, or receipts but are not, for various reasons, reflected in the program details. For example, the budget might include an allowance to show the effect on the budget totals of a proposal that would actually affect many accounts by relatively small amounts, in order to avoid unnecessary detail in the presentations for the individual accounts.

Baseline

The budget baseline is an estimate of the receipts, outlays, and deficits or surpluses that would occur if no changes were made to current laws during the period covered by the budget. The baseline assumes that receipts and mandatory spending, which generally are authorized on a permanent basis, will continue in the future as required by current law. The baseline assumes that the future funding for discretionary programs, which generally are funded annually, will equal the most recently enacted appropriation, adjusted for inflation. This year, the baseline estimates assume enactment of S. 1932, the Deficit Reduction Act, which was pending in the Congress at the time the budget was prepared.

The baseline represents the amount of resources, in real terms, that would be used by the Government over the period covered by the budget on the basis of laws currently enacted. (Chapter 25 of this volume, "Current Services Estimates," provides more information on the baseline.)

The baseline serves several useful purposes:

- It may warn of future problems, either for Government fiscal policy as a whole or for individual tax and spending programs.
- It provides a starting point for formulating the President's budget.
- It provides a "policy-neutral" benchmark against which the President's budget and alternative proposals can be compared to assess the magnitude of proposed changes.

PRINCIPAL BUDGET LAWS

The following basic laws govern the Federal budget process:

- ***Article 1, section 8, clause 1 of the Constitution***, which empowers the Congress to collect taxes.
- ***Article 1, section 9, clause 7 of the Constitution***, which requires appropriations in law before money may be spent from the Treasury and the publication of a regular statement of the receipts and expenditures of all public money.
- ***Antideficiency Act (codified in Chapters 13 and 15 of Title 31, United States Code***), which prescribes rules and procedures for budget execution.
- ***Chapter 11 of Title 31, United States Code***, which prescribes procedures for submission of the President's budget and information to be contained in it.
- ***Congressional Budget and Impoundment Control Act of 1974 (Public Law 93–344)***, as amended. This Act comprises the:
  - —Congressional Budget Act of 1974, as amended, which prescribes the congressional budget process; and
  - —Impoundment Control Act of 1974, which controls certain aspects of budget execution.
- ***Balanced Budget and Emergency Deficit Control Act of 1985 (Public Law 99–177)***, as

amended, which prescribes rules and procedures (including "sequestration") designed to eliminate excess spending.

- ***Budget Enforcement Act of 1990 (Title XIII, Public Law 101–508)***, which significantly amended key laws pertaining to the budget process, including the Congressional Budget Act and the Balanced Budget and Emergency Deficit Control Act. The Budget Enforcement Act of 1997 (Title X, Public Law 105–33) extended the BEA requirements through 2002 and altered some of the requirements. The requirements, generally referred to as BEA requirements (discretionary spending limits, pay-as-you-go, sequestration, etc.), are part of the Balanced Budget and Emergency Deficit Control Act. The BEA expired at the end of 2002.
- ***Federal Credit Reform Act of 1990, as amended (2 USC 661–661f)***, a part of the Budget Enforcement Act of 1990, which amended the Congressional Budget Act to prescribe the budget treatment for Federal credit programs.
- ***Government Performance and Results Act of 1993 (Public Law 103–62, as amended)***, which emphasizes managing for results. It requires agencies to prepare strategic plans, annual performance plans, and annual performance reports.

GLOSSARY OF BUDGET TERMS

Advance appropriation means appropriations of new budget authority that become available one or more fiscal years beyond the fiscal year for which the appropriation act was passed.

Advance funding means appropriations of budget authority provided in an appropriations act to be used, if necessary, to cover obligations incurred late in the fiscal year for benefit payments in excess of the amount specifically appropriated in the act for that year, where the budget authority is charged to the appropriation for the program for the fiscal year following the fiscal year for which the appropriations act is passed.

Agency means a department or other establishment of the Government.

Allowance means a lump-sum included in the budget to represent certain transactions that are expected to increase or decrease budget authority, outlays, or receipts but that are not, for various reasons, reflected in the program details.

Balances of budget authority means the amounts of budget authority provided in previous years that have not been outlayed.

Baseline means an estimate of the receipts, outlays, and deficit or surplus that would result from continuing current law through the period covered by the budget.

Budget means the Budget of the United States Government, which sets forth the President's comprehensive financial plan for allocating resources and indicates the President's priorities for the Federal Government.

Budget authority (BA) means the authority provided by law to incur financial obligations that will result in outlays. (For a description of the several forms of budget authority, see "Budget Authority and Other Budgetary Resources" earlier in this chapter.)

Budget totals mean the totals included in the budget for budget authority, outlays, and receipts. Some presentations in the budget distinguish on-budget totals from off-budget totals. On-budget totals reflect the transactions of all Federal Government entities except those excluded from the budget totals by law. The off-budget totals reflect the transactions of Government entities that are excluded from the on-budget totals by law. Under current law, the off-budget totals include the Social Security trust funds (Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds) and the Postal Service Fund. The budget combines the on- and off-budget totals to derive unified or consolidated totals for Federal activity.

Budgetary resources mean amounts available to incur obligations in a given year. The term comprises new budget authority and unobligated balances of budget authority provided in previous years.

Cap means the legal limits for each fiscal year under the Budget Enforcement Act on the budget authority and outlays provided by discretionary appropriations.

Cash equivalent transaction means a transaction in which the Government makes outlays or receives collections in a form other than cash or the cash does not accurately measure the cost of the transaction. (For examples, see the section on "Outlays" earlier in this chapter.)

Collections mean money collected by the Government that the budget records as either a receipt, an offsetting collection, or an offsetting receipt.

Credit program account means a budget account that receives and obligates appropriations to cover the subsidy cost of a direct loan or loan guarantee and disburses the subsidy cost to a financing account.

Current services estimate—see baseline.

Deficit means the amount by which outlays exceed receipts in a fiscal year. It may refer to the on-budget, off-budget, or unified budget deficit.

Direct loan means a disbursement of funds by the Government to a non-Federal borrower under a contract that requires the repayment of such funds with or without interest. The term includes the purchase of, or participation in, a loan made by another lender. The term also includes the sale of a Government asset on credit terms of more than 90 days duration as well as financing arrangements for other transactions that defer payment for more than 90 days. It also includes loans financed by the Federal Financing Bank (FFB) pursuant to agency loan guarantee authority. The term does not include the acquisition of a federally guaranteed loan in satisfaction of default or other guarantee claims or the price support loans of the Commodity Credit Corporation. (Cf. loan guarantee.)

Direct spending—see mandatory spending.

Discretionary spending means budgetary resources (except those provided to fund mandatory spending programs) provided in appropriations acts. (Cf. mandatory spending.)

Emergency appropriation means an appropriation that the President and the Congress have designated as an emergency requirement. Such spending is not subject to the limits on discretionary spending, if it is discretionary spending, or the pay-as-you-go rules, if it is mandatory.

Federal funds group refers to the moneys collected and spent by the Government through accounts other than those designated as trust funds. Federal funds include general, special, public enterprise, and intragovernmental funds. (Cf. trust funds.)

Financing account means a non-budgetary account (its transactions are excluded from the budget totals) that records all of the cash flows resulting from post-1991 direct loan obligations or loan guarantee commitments. At least one financing account is associated with each credit program account. For programs that make both direct loans and loan guarantees, there are separate financing accounts for the direct loans and the loan guarantees. (Cf. liquidating account.)

Fiscal year means the Government's accounting period. It begins on October 1st and ends on September 30th, and is designated by the calendar year in which it ends.

Forward funding means appropriations of budget authority that are made for obligation in the last quarter of the fiscal year for the financing of ongoing grant programs during the next fiscal year.

General fund means the accounts for receipts not earmarked by law for a specific purpose, the proceeds of general borrowing, and the expenditure of these moneys.

Intragovernmental fund—see revolving fund.

Liquidating account means a budget account that records all cash flows to and from the Government resulting from pre-1992 direct loan obligations or loan guarantee commitments. (Cf. financing account.)

Loan guarantee means any guarantee, insurance, or other pledge with respect to the payment of all or a part of the principal or interest on any debt obligation of a non-Federal borrower to a non-Federal lender. The term does not include the insurance of deposits, shares, or other withdrawable accounts in financial institutions. (Cf. direct loan.)

Mandatory spending means spending controlled by laws other than appropriations acts (including spending for entitlement programs) and spending for the food stamp program. Although the Budget Enforcement Act uses the term direct spending to mean this, mandatory spending is commonly used instead. (Cf. discretionary spending.)

Means of financing refers to borrowing, the change in cash balances, and certain other transactions involved in financing a deficit. The term is also used to refer to the debt repayment, the change in cash balances, and certain other transactions involved in using a surplus. By definition, the means of financing are not treated as receipts or outlays.

Obligated balance means the cumulative amount of budget authority that has been obligated but not yet outlayed. (Cf. unobligated balance.)

Obligation means a binding agreement that will result in outlays, immediately or in the future. Budgetary resources must be available before obligations can be incurred legally.

Off-budget—see budget totals.

Offsetting collections mean collections that, by law, are credited directly to expenditure accounts and deducted from gross budget authority and outlays of the expenditure account, rather than added to receipts. Usually, they are authorized to be spent for the purposes of the account without further action by Congress. They result from business-like transactions or market-oriented activities with the public and other Government accounts. The authority to spend offsetting collections is a form of budget authority. (Cf. receipts and offsetting receipts.)

Offsetting receipts mean collections that are credited to offsetting receipt accounts and deducted from gross budget authority and outlays, rather than added to receipts. They are not authorized to be credited to expenditure accounts. The legislation that authorizes the offsetting receipts may earmark them for a specific purpose and either appropriate them for expenditure for that purpose or require them to be appropriated in annual appropriation acts before they can be spent. Like offsetting collections, they result from business-like transactions or market-oriented activities with the public and other Government accounts. (Cf. receipts, undistributed offsetting receipts, and offsetting collections.)

On-budget—see budget totals.

Outlay means a payment to liquidate an obligation (other than the repayment of debt principal). Outlays generally are equal to cash disbursements but also are recorded for cash-equivalent transactions, such as the issuance of debentures to pay insurance claims, and in a few cases are recorded on an accrual basis such as interest on public issues of the public debt. Outlays are the measure of Government spending.

Outyear estimates means estimates presented in the budget for the years beyond the budget year (usually four) of budget authority, outlays, receipts, and other items (such as debt).

Pay-as-you-go (PAYGO) means the requirements of the Budget Enforcement Act that result in a sequestration if the estimated combined result of legislation affecting mandatory spending or receipts is a net cost for a fiscal year.

Public enterprise fund—see revolving fund.

Receipts mean collections that result from the Government's exercise of its sovereign power to tax or otherwise compel payment and gifts of money to the Government. They are compared to outlays in calculating a surplus or deficit. (Cf. offsetting collections and offsetting receipts.)

Revolving fund means a fund that conducts continuing cycles of business-like activity, in which the fund charges for the sale of products or services and uses the proceeds to finance its spending, usually without requirement for annual appropriations. There are two types of revolving funds: Public enterprise funds, which conduct business-like operations mainly with the public, and intragovernmental revolving funds, which conduct business-like operations mainly within and between Government agencies.

Scorekeeping means measuring the budget effects of legislation, generally in terms of budget authority, receipts, and outlays for purposes of the Budget Enforcement Act.

Sequestration means the cancellation of budgetary resources provided by discretionary appropriations or mandatory spending legislation, following various procedures prescribed by the Budget Enforcement Act. A sequestration may occur in response to a discretionary appropriation that causes discretionary spending to exceed the discretionary spending caps set by the Budget Enforcement Act or in response to net costs resulting from the combined result of legislation affecting mandatory spending or receipts (referred to as a "pay-as-you-go" sequestration).

Special fund means a Federal fund account for receipts or offsetting receipts earmarked for specific purposes and the expenditure of these receipts. (Cf. trust fund.)

Subsidy means the estimated long-term cost to the Government of a direct loan or loan guarantee, calculated on a net present value basis, excluding administrative costs and any incidental effects on governmental receipts or outlays.

Surplus means the amount by which receipts exceed outlays in a fiscal year. It may refer to the on-budget, off-budget, or unified budget surplus.

Supplemental appropriation means an appropriation enacted subsequent to a regular annual appropriations act, when the need for funds is too urgent to be postponed until the next regular annual appropriations act.

Trust fund refers to a type of account, designated by law as a trust fund, for receipts or offsetting receipts earmarked for specific purposes and the expenditure of these receipts. Some revolving funds are designated as trust funds, and these are called trust revolving funds. (Cf. special fund and revolving fund.)

Trust funds group refers to the moneys collected and spent by the Government through trust fund accounts. (Cf., Federal funds group.)

Undistributed offsetting receipts mean offsetting receipts that are deducted from the Government-wide totals for budget authority and outlays instead of offset against a specific agency and function. (Cf. offsetting receipts.)

Unobligated balance means the cumulative amount of budget authority that is not obligated and that remains available for obligation under law.

User charges are charges assessed for the provision of Government services and for the sale or use of Government goods or resources. The payers of the user charge must be limited in the authorizing legislation to those receiving special benefits from, or subject to regulation by, the program or activity beyond the benefits received by the general public or broad segments of the public (such as those who pay income taxes or custom duties).

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