

# ANALYTICAL PERSPECTIVES



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BUDGET OF THE UNITED STATES GOVERNMENT

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*Fiscal Year 2008*

## THE BUDGET DOCUMENTS

***Budget of the United States Government, Fiscal Year 2008*** contains the Budget Message of the President, information on the President's priorities, and budget overviews organized by agency.

***Analytical Perspectives, Budget of the United States Government, Fiscal Year 2008*** 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; 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, 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 2008*** 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 2008 or 2012. To the extent feasible, the data have been adjusted to provide consistency with the 2008 Budget and to provide comparability over time.

***Appendix, Budget of the United States Government, Fiscal Year 2008*** 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 ap-

propriation accounts than any of the other budget documents. It includes for each agency: the proposed text of appropriations language; budget schedules for each account; 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 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, only two of the appropriations bills for 2007 had been enacted; therefore, the programs provided for in the remaining 2007 appropriations bills were operating under a continuing resolution (P.L. 109-289, Division B, as amended). For these programs, references to 2007 spending in the text and tables reflect the levels provided by the continuing resolution.

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# TABLE OF CONTENTS

	<i>Page</i>
<b>List of Charts and Tables</b> .....	v
<b>Introduction</b>	
1. Introduction .....	3
<b>Performance and Management Assessments</b>	
2. Budget and Performance Integration .....	9
<b>Crosscutting Programs</b>	
3. Homeland Security Funding Analysis .....	19
4. Strengthening Federal Statistics .....	37
5. Research and Development .....	45
6. Federal Investment .....	55
7. Credit and Insurance .....	67
8. Aid to State and Local Governments .....	101
9. Integrating Services with Information Technology .....	153
10. Federal Drug Control Funding .....	159
11. California-Federal Bay-Delta Program Budget Crosscut (CALFED) .....	161
<b>Economic Assumptions and Analyses</b>	
12. Economic Assumptions .....	165
13. Stewardship .....	175
14. National Income and Product Accounts .....	203
<b>Budget Reform Proposals</b>	
15. Budget Reform Proposals .....	211
<b>Federal Borrowing and Debt</b>	
16. Federal Borrowing and Debt .....	223

---

**TABLE OF CONTENTS—Continued**

	<i>Page</i>
<b>Federal Receipts and Collections</b>	
17. Federal Receipts .....	239
18. User Charges and Other Collections .....	271
19. Tax Expenditures .....	285
<b>Dimensions of the Budget</b>	
20. Comparison of Actual to Estimated Totals .....	331
21. Outlays to the Public, Gross and Net .....	339
22. Trust Funds and Federal Funds .....	341
23. Off-Budget Federal Entities and Non-Budgetary Activities .....	357
24. Federal Employment and Compensation .....	361
<b>Current Services Estimates</b>	
25. Current Services Estimates .....	371
<b>The Budget System and Concepts</b>	
26. The Budget System and Concepts .....	391
<b>Detailed Functional Tables</b>	
27. Budget Authority and Outlays by Function, Category, and Program .....	CD-ROM
<b>Federal Programs by Agency and Account</b>	
28. Federal Programs by Agency and Account .....	CD-ROM

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## LIST OF CHARTS AND TABLES

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## LIST OF CHARTS AND TABLES

### LIST OF CHARTS

	<i>Page</i>
2-1. Program Ratings are Improving .....	15
4-1. ICSP Statistical Quality and Program Performance Dimensions .....	38
4-2. Most Recent PART Summary Ratings for Statistical Programs .....	40
5-1. Research in the American Competitiveness Initiative .....	45
5-2. Scores of R&D PART Assessments .....	47
7-1. Fannie Mae and Freddie Mac Combined Retained Mortgage Portfolios Year-End 2005 .....	74
7-2. Face Value of Federal Credit Outstanding .....	87
13-1. The Financial Condition of the Federal Government and the Nation .....	177
13-2. Net Federal Liabilities .....	180
13-3. Health Care Cost Alternatives .....	185
13-4. Effect of Entitlement Savings .....	186
13-5. Alternative Receipts Projections .....	186
13-6. Alternative Productivity Assumptions .....	187
13-7. Alternative Fertility Assumptions .....	187
13-8. Alternative Immigration Assumptions .....	188
13-9. Alternative Mortality Assumptions .....	188
13-10. Sources of the Gross Tax Gap .....	194
17-1. Major Provisions of the Tax Code Under the 2001, 2003, 2004 and 2006 Enacted Tax Relief ....	240
20-1. Illustrative Range of Budget Outcomes .....	337
24-1. Post Cold War End Strength and Spending .....	362
24-2. DoD Direct Compensation Costs .....	363
26-1. Relationship of Budget Authority to Outlays for 2008 .....	402

### LIST OF TABLES

#### ***Crosscutting Programs***

##### Homeland Security Funding Analysis:

	<i>Page</i>
3-1. Homeland Security Funding by Agency .....	20
3-2. Homeland Security Funding by National Strategy Mission Area .....	21
3-3. Intelligence and Warning Funding .....	22
3-4. Border and Transportation Security Funding .....	23
3-5. Domestic Counterterrorism Funding .....	25
3-6. Protecting Critical Infrastructure and Key Assets Funding .....	26
3-7. Defending Against Catastrophic Threats Funding .....	28
3-8. Emergency Preparedness and Response Funding .....	29
3-9. Discretionary Fee-Funded Homeland Security Activities by Agency .....	32
3-10. Mandatory Homeland Security Funding by Agency .....	32
3-11. Baseline Estimates—Total Homeland Security Funding by Agency .....	33
3-12. Homeland Security Funding by Budget Function .....	34
3-13. Baseline Estimates—Homeland Security Funding by Budget Function .....	35
Appendix—Homeland Security Mission Funding by Agency and Budget Account .....	CD-ROM

## LIST OF TABLES—Continued

	<i>Page</i>
Strengthening Federal Statistics:	
4-1. 2006–2008 Budget Authority for Principal Statistical Agencies .....	43
Research and Development:	
5-1. Federal Research and Development .....	51
5-2. Federal Science and Technology Budget .....	53
5-3. Agency Detail of Selected Interagency R&D Efforts .....	54
Federal Investment:	
6-1. Composition of Federal Investment Outlays .....	57
6-2. Federal Investment Budget Authority and Outlays: Grant and Direct Federal Programs .....	58
6-3. Summary of PART Ratings and Scores for Direct Federal Investment Programs .....	61
6-4. Net Stock of Federally Financed Physical Capital .....	64
6-5. Net Stock of Federally Financed Research and Development .....	65
6-6. Net Stock of Federally Financed Education Capital .....	66
Credit and Insurance:	
Text Tables:	
Summary of PART Scores .....	69
Largest Ten Claims Against the PBGC's Single-Employer Insurance Program, 1975–2006 .....	83
7-1. Estimated Future Cost of Outstanding Federal Credit Programs .....	87
7-2. Reestimates of Credit Subsidies on Loans Disbursed Between 1992–2006 .....	89
7-3. Direct Loan Subsidy Rates, Budget Authority, and Loan Levels, 2006–2008 .....	91
7-4. Loan Guarantee Subsidy Rates, Budget Authority, and Loan Levels, 2006–2008 .....	92
7-5. Summary of Federal Direct Loans and Loan Guarantees .....	93
7-6. Direct Loan Writeoffs and Guaranteed Loan Terminations for Defaults .....	94
7-7. Appropriations Acts Limitations on Credit Loan Levels .....	96
7-8. Face Value of Government-Sponsored Lending .....	98
7-9. Lending and Borrowing By Government-Sponsored Enterprises (GSEs) .....	99
7-10. Direct Loan Transactions of the Federal Government .....	CD-ROM
7-11. Guaranteed Loan Transactions of the Federal Government .....	CD-ROM
Aid to State and Local Governments:	
8-1. Federal Grant Outlays by Agency .....	101
8-2. Summary of PART Ratings and Scores for Grants to State and Local Governments .....	105
8-3. Trends in Federal Grants to State and Local Governments .....	107
8-4. Federal Grants to State and Local Governments—Budget Authority and Outlays .....	110
8-5. Summary of Programs by Agency, Bureau, and Program .....	119
8-6. Summary of Programs by State .....	120
8-7. School Breakfast Program .....	121
8-8. National School Lunch Program .....	122
8-9. Special Supplemental Nutrition Program for Women, Infants, and Children (WIC) .....	123
8-10. Child and Adult Care Food Program .....	124
8-11. State Administrative Matching Grants for Food Stamp Program .....	125
8-12. Title I Grants to Local Educational Agencies .....	126
8-13. Improving Teacher Quality State Grants .....	127
8-14. Special Education—Grants to States .....	128
8-15. Rehabilitation Services—Vocational Rehabilitation Grants to States .....	129
8-16. State Children's Health Insurance Program .....	130
8-17. Grants to States for Medicaid .....	131
8-18. Temporary Assistance for Needy Families (TANF)—Family Assistance Grants .....	132
8-19. Child Support Enforcement—Federal Share of State and Local Administrative Costs and Incentives .....	133
8-20. Low Income Home Energy Assistance Program .....	134



## LIST OF TABLES—Continued

	<i>Page</i>
8–21. Child Care and Development Block Grant .....	135
8–22. Child Care and Development Fund—Mandatory .....	136
8–23. Child Care and Development Fund—Matching .....	137
8–24. Head Start .....	138
8–25. Foster Care—Title IV–E .....	139
8–26. Adoption Assistance .....	140
8–27. Social Services Block Grant .....	141
8–28. Homeland Security Grant Program .....	142
8–29. Disaster Grants—Public Assistance (Presidentially Declared Disasters) .....	143
8–30. Public Housing Operating Fund .....	144
8–31. Section 8 Housing Choice Vouchers .....	145
8–32. Public Housing Capital Fund .....	146
8–33. Community Development Block Grants .....	147
8–34. Mineral Leasing and Associated Payments .....	148
8–35. Airport Improvement Program .....	149
8–36. Highway Planning and Construction .....	150
8–37. Capital Investment Grants—Fixed Guideway Modernization .....	151
8–38. Federal Transit Formula Grants and Research .....	152
Integrating Services with Information Technology:	
9–1. Effectiveness of Agency’s IT Management and E-Gov Processes .....	CD-ROM
9–2. Management Guidance .....	CD-ROM
9–3. Agencies with IT Investments on the Management Watch List .....	CD-ROM
9–4. Status of the Presidential E-Government Initiatives .....	CD-ROM
9–5. Lines of Business (LoB) Update .....	CD-ROM
Federal Drug Control Funding:	
10–1. Federal Drug Control Funding, FY 2006–2008 .....	159
California-Federal Bay-Delta Program Budget Crosscut (CALFED):	
Text Table:	
CALFED-Related Federal Funding Budget Crosscut .....	161
CALFED FY 1998–2008 Budget Crosscut Methodology .....	CD-ROM
CALFED Federal Agency Funding—Summary by Category and Agency Breakout .....	CD-ROM
CALFED Project Descriptions .....	CD-ROM
CALFED Fiscal Years 2005–2006 Federal Funding .....	CD-ROM
CALFED Fiscal Years 2007–2008 Funding Under New and Old Authority .....	CD-ROM
CALFED State Agency Funding .....	CD-ROM
Department of the Interior Certification of Budget Numbers .....	CD-ROM
<b><i>Economic Assumptions and Analyses</i></b>	
Economic Assumptions:	
12–1. Economic Assumptions .....	168
12–2. Comparison of Economic Assumptions .....	170
12–3. Comparison of Economic Assumptions in the 2007 and 2008 Budgets .....	171
12–4. Adjusted Structural Balance .....	171
12–5. Sensitivity of the Budget to Economic Assumptions .....	173
Stewardship:	
13–1. Government Assets and Liabilities .....	181
13–2. Long-Run Budget Projections .....	184
13–3. Benefits in Excess of Future Taxes and Premiums—Actuarial Present Values .....	192
13–4. Sources of the Tax Gap from Income Underreporting .....	194
13–5. National Wealth .....	196
13–6. Trends in National Wealth .....	197
13–7. Economic and Social Indicators .....	198

## LIST OF TABLES—Continued

	<i>Page</i>
National Income and Product Accounts:	
14-1. Federal Transactions in the National Income and Product Accounts, 1997-2008 .....	205
14-2. Relationship of the Budget to the Federal Sector, NIPA's .....	207
<b><i>Budget Reform Proposals</i></b>	
Budget Reform Proposals:	
15-1. Mandatory Proposals Subject to PAYGO .....	211
15-2. Discretionary Caps and Adjustments .....	213
15-3. Program Integrity Base and Cap Adjustments .....	214
15-4. Direct Savings Estimated from 2008 Program Integrity Funding .....	215
15-5. Transportation Category for Highways and Mass Transit Spending .....	216
<b><i>Federal Borrowing and Debt</i></b>	
Federal Borrowing and Debt:	
16-1. Trends in Federal Debt Held by the Public .....	223
16-2. Federal Government Financing and Debt .....	225
16-3. Agency Debt .....	228
16-4. Debt Held by Government Accounts .....	230
16-5. Federal Funds Financing and Change in Debt Subject to Statutory Limit .....	234
16-6. Foreign Holdings of Federal Debt .....	235
<b><i>Federal Receipts and Collections</i></b>	
Federal Receipts:	
17-1. Receipts by Source—Summary .....	239
17-2. Effect on Receipts of Changes in the Social Security Taxable Earnings Base .....	239
17-3. Effect of Proposals on Receipts .....	266
17-4. Receipts by Source .....	269
User Charges and Other Collections:	
18-1. Gross Outlays, User Charges, Other Offsetting Collections and Receipts from the Public, and Net Outlays .....	271
18-2. Total User Charge Collections .....	274
18-3. User Fee and Other User Charge Proposals .....	276
18-4. Offsetting Collections and Receipts from the Public .....	281
18-5. Offsetting Receipts by Type .....	282
Tax Expenditures:	
19-1. Estimates of Total Income Tax Expenditures .....	287
19-2. Estimates of Tax Expenditures for the Corporate and Individual Income Taxes .....	291
19-3. Income Tax Expenditures Ranked by Total 2008-2012 Projected Revenue Effect .....	296
19-4. Present Value of Selected Tax Expenditures for Activity in Calendar Year 2006 .....	299
Appendix A: Treasury Review of the Tax Expenditure Presentation .....	313
Appendix Tables:	
1. Comparison of Current Tax Expenditures with Those Implied by a Comprehensive Income Tax .....	322
2. Comparison of Current Tax Expenditures with Those Implied by a Comprehensive Consumption Tax .....	323
3. Revised Tax Expenditure Estimates .....	323
Appendix B: Performance Measures and the Economic Effects of Tax Expenditures .....	324
<b><i>Dimensions of the Budget</i></b>	
Comparison of Actual to Estimated Totals:	
20-1. Comparison of Actual 2006 Receipts with the Initial Current Services Estimates .....	331
20-2. Comparison of Actual 2006 Outlays with the Initial Current Services Estimates .....	332
20-3. Comparison of the Actual 2006 Deficit with the Initial Current Services Estimate .....	333

## LIST OF TABLES—Continued

	<i>Page</i>
20–4. Comparison of Actual and Estimated Outlays for Mandatory and Related Programs Under Current Law .....	334
20–5. Reconciliation of Final Amounts for 2006 .....	335
20–6. Comparison of Estimated and Actual Surpluses or Deficits Since 1982 .....	336
20–7. Differences Between Estimated and Actual Surpluses or Deficits for Five-Year Budget Estimates Since 1982 .....	337
Outlays to Public, Gross and Net:	
21–1. Total Outlays, Gross and Net of Offsetting Collections and Receipts from the Public, by Agency, 2006–2008 .....	339
Trust Funds and Federal Funds:	
22–1. Receipts, Outlays, and Surplus or Deficit by Fund Group .....	342
22–2. Income, Outgo, and Balances of Trust Funds Group .....	343
22–3. Relationship of Total Federal Fund and Trust Fund Receipts to Unified Budget Receipts, Fiscal Year 2006 .....	344
22–4. Income, Outgo, and Balances of Major Trust Funds .....	346
22–5. Income, Outgo, and Balances of Selected Federal Funds .....	353
Off-Budget Federal Entities and Non-Budgetary Activities:	
23–1. Comparison of Total, On-Budget, and Off-Budget Transactions .....	358
Federal Employment and Compensation:	
Text Table:	
Overseas Staffing Under Chief of Mission Authority .....	363
24–1. Federal Civilian Employment in the Executive Branch .....	364
24–2. Total Federal Employment (As measured by total positions filled) .....	365
24–3. Total Federal Employment (As measured by Full-Time Equivalents) .....	366
24–4. Personnel Compensation and Benefits .....	367
<b>Current Services Estimates</b>	
Current Services Estimates:	
25–1. Baseline Category Totals .....	371
25–2. Impact of Budget Policy .....	372
25–3. Alternative Baseline Assumptions .....	374
25–4. Summary of Economic Assumptions .....	374
25–5. Beneficiary Projections for Major Benefit Programs .....	375
25–6. Impact of Regulations, Expiring Authorizations, and Other Assumptions in the Baseline .....	376
25–7. Baseline Receipts by Source .....	382
25–8. Change in Baseline Outlay Estimates by Category .....	383
25–9. Current Services Outlays by Function .....	384
25–10. Current Services Outlays by Agency .....	385
25–11. Current Services Budget Authority by Function .....	386
25–12. Current Services Budget Authority by Agency .....	387
25–13. Current Services Budget Authority by Function, Category and Program .....	CD-ROM
25–14. Current Services Outlays by Function, Category and Program .....	CD-ROM
<b>The Budget System and Concepts</b>	
The Budget System and Concepts:	
26–1. Totals for the Budget and the Federal Government .....	395
<b>Detailed Functional Tables</b>	
Detailed Functional Tables:	
27–1. Budget Authority and Outlays by Function, Category and Program .....	CD-ROM
<b>Federal Programs by Agency and Account</b>	
Federal Programs by Agency and Account:	
28–1. Federal Programs by Agency and Account .....	CD-ROM



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# INTRODUCTION

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# 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. This 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, the 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 *Analytical Perspectives* 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. Increased 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, “Budget and Performance Integration,” and is discussed in many other chapters, especially those in the section, “Crosscutting Programs.” One-page summaries of each program assessment are available at [www.ExpectMore.gov](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 of the subsequent chapters 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 [www.ExpectMore.gov](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 the related 2008 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. Also included in this chapter is 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, risks, and performance of Federal credit and insurance programs and Government-sponsored enterprises (GSEs). 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). 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 chapter presents crosscutting information on Federal grants to State and local governments, including highlights of Administration proposals. This 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). It 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. Five detailed tables: “Table 9–1. Effectiveness of Agency’s IT Management and E-Gov Proc-

esses,” “Table 9–2. Management Guidance,” “Table 9–3. Agencies with IT Investments on the Management Watch List,” “Table 9–4. Status of Presidential E-Government Initiatives,” and “Table 9–5. Lines of Business (LoB) Update” are on the enclosed *Analytical Perspectives* CD-ROM.

10. *Federal Drug Control Funding*. This chapter 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 chapter reviews recent economic developments; presents the Administration’s assessment of the economic situation and outlook, including the 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 costs, productivity, and demographics; actuarial estimates for the shortfalls in Social Security and Medicare; a discussion of tax compliance; 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 (GDP) and for analyzing the effect of the budget on aggregate economic activity.

### **Budget Reform Proposals**

15. *Budget Reform Proposals*. This chapter includes 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 chapter 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 chapter 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.

### **Dimensions of the Budget**

20. *Comparison of Actual to Estimated Totals*. This chapter compares the actual receipts, outlays, and deficit for 2006 with the estimates for that year published two years ago in the 2006 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 chapter 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.

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, overseas staffing, and the full compensation of military personnel.

### **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 25–13. Current Services Budget Authority by Function, Category, and Program” and “Table 25–14. 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 chapter includes 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”.



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# PERFORMANCE AND MANAGEMENT ASSESSMENTS

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## 2. BUDGET AND PERFORMANCE INTEGRATION

### I. INTRODUCTION

Good Government—a government fiscally responsible to the people—must have as one of its core purposes the achievement of results for the taxpayers. Taxpayers expect the Federal Government to implement programs that will ensure the Nation’s security and provide critical services. Taxpayers want their money spent wisely and used to gain maximum benefit. Taxpayers have the right to hold the Federal Government accountable for its actions. To exercise this right, the taxpayers must have clear, candid, and up-to-date information about each program’s successes and failures. For the second straight year, the Administration is providing this type of information to all Americans on *ExpectMore.gov*, a user-friendly government website that describes which programs are performing, which ones are not, and in both situations, what is being done to improve them. (Greater detail about *ExpectMore.gov* will be provided in a subsequent section.)

The Administration is making the Federal Government increasingly effective by making program budget decisions based on program performance. The objective of the President’s Budget and Performance Integration (BPI) Initiative is to ensure that Federal dollars produce the greatest results. Under the BPI Initiative, agencies and OMB identify which programs work well, which are deficient, and what can be done to improve performance of each program. In some cases, the Administration may find it necessary to reallocate funding from less effective programs to more effective ones. The final decisions about the scope of programs and the size of program budgets are ultimately made jointly by the Congress and the President. The BPI Initiative provides information on program performance to help the Executive and Legislative branches make better, more informed decisions. Information about program performance is now readily available and accessible to the public on *ExpectMore.gov*.

The BPI Initiative measures a program’s success in two principal ways:

- *Improved Program Performance*: 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. Agencies have ready access to program performance information by using the results of the Program Assessment Rating Tool (PART) assessments of each program, program evaluations, investigations, audits, and analyses from a variety of sources.
- *Greater Investment in Successful Programs*: Overall, there are now more program-funding needs

and thus fewer resources to be allocated to each funded program. These scarce resources need to be allocated to programs that benefit the Nation most effectively and efficiently. Though performance is not the only factor used to decide the size of a program’s budget, Congress and the President can utilize information about a program’s effectiveness and efficiency in decision-making so that taxpayer dollars are invested in programs that provide the greatest return to the Nation. If poor performing programs are unable to demonstrate improved results, then their resources may be re-allocated to programs that can demonstrate greater success and returns to the taxpayer.

Currently, the BPI 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. For example:

- The Social Security Administration increased agency productivity by 13.1 percent since 2001 through increased use of information technology and improved business processes. SSA would have required \$800 million more in 2006 to process the same work if productivity improvements had not been realized.
- In 2005, the Bureau of Prisons reduced the construction cost per bed in high security facilities, saving an estimated \$54 million.
- The Federal Transit Administration implemented its plan to process Formula Grants faster. In the past, the highest reported processing time for processing grants was 90 days. FTA now expects to process such grants within only 36 days.

Agencies are identifying additional actions to improve the performance of each of their programs. All agencies, regardless of whether their programs perform poorly or well, strive for increased program performance each year.

Progress toward the second goal of improving resource allocation has been slow, but this year, the administration had greater success. We have been successful in terminating some low-performing programs and better at targeting resources to well-performing programs. In 2006, seven programs were terminated, saving \$230 million. Four programs were reduced, saving \$300 million. Though no decision is based purely on performance, overall, high performing programs received larger funding increases than those that did not perform as well.

## II. HOW THE BUDGET AND PERFORMANCE INTEGRATION INITIATIVE WORKS

Several aspects of the Budget Performance Integration (BPI) Initiative are designed to maximize program performance. They include:

- Assessment of performance with the PART (Program Assessment Rating Tool);
- Publishing a Scorecard to hold agencies accountable for managing for results, addressing PART findings, and implementing follow-up actions;
- Broadcasting results to the public on *ExpectMore.gov*; and
- Facilitating program improvement through inter-agency collaboration and cooperation.

### **Comprehensive Assessment with the Program Assessment Rating Tool (PART)**

How do we ensure that Federal programs are improving every year? First, we assess their current performance. In order to improve a program's outcomes, it is critical to have a good understanding of how the program is currently performing. To date, we have assessed the performance of nearly 1,000 programs, comprising 96 percent of all Federal programs, using the PART.

### **History of the PART**

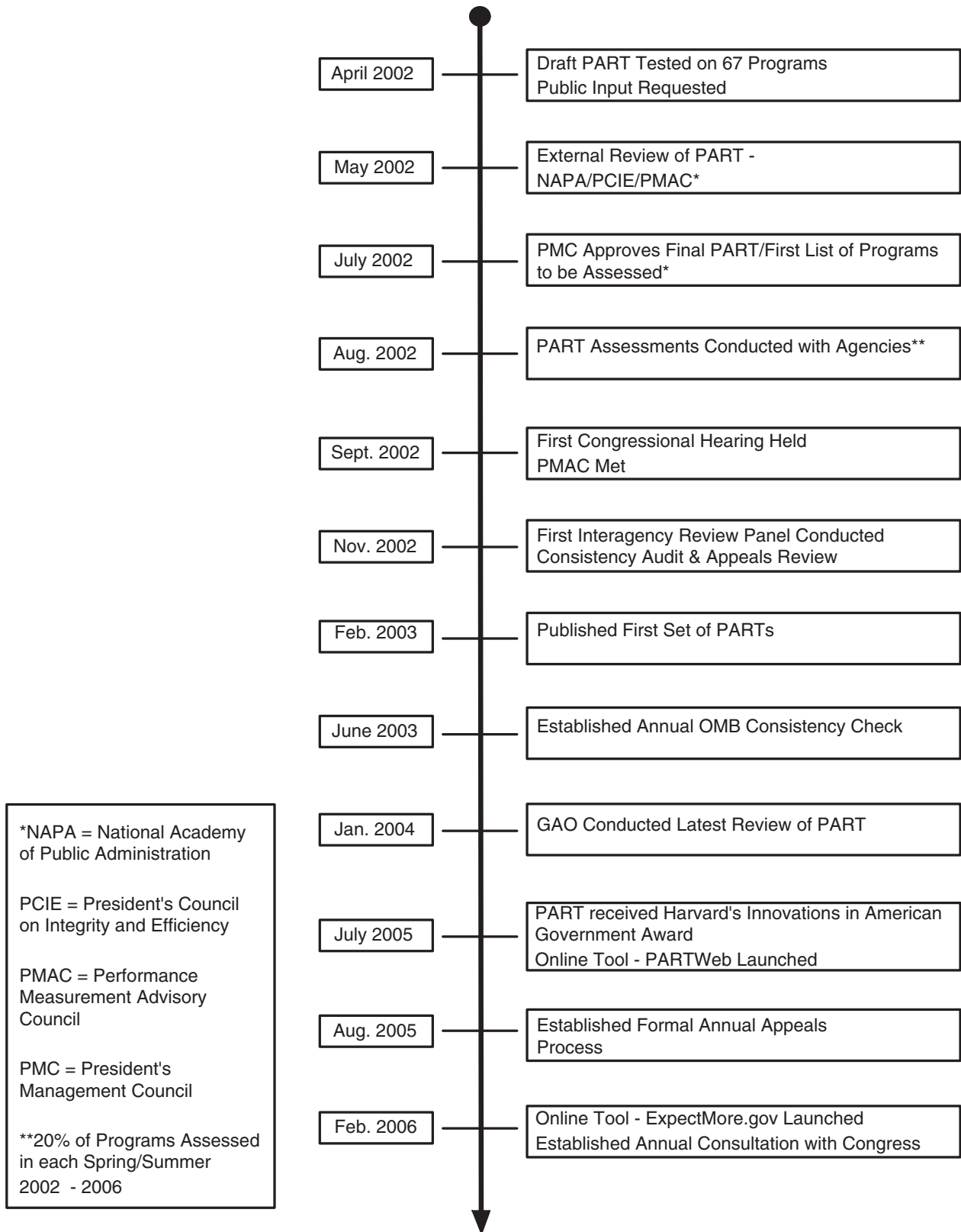
The Federal Government spends trillions of dollars on programs annually, but until the advent of the PART, there was not a uniform basis for assessing how well these programs actually work. For example, were the billions of taxpayer dollars the Federal Government spent on foster care actually preventing the maltreatment and abuse of children? Are Federal efforts to reduce air pollution successful? Previous administrations from President Johnson to President Clinton and Congress have grappled with this problem. Each prior administration has tried to come up with means by which government programs are measured for results. The most significant advance in bringing accountability to government programs was the Government Performance and Results Act of 1993 (GPRA). This law requires

Federal agencies to identify both annual and long-term goals and collect and report performance data. For the first time, agencies were required to explicitly identify measures and goals for judging the performance of each of their programs and to collect information on an annual basis in order to determine if they were meeting those goals.

This Administration built upon GPRA requirements by creating the PART (Program Assessment Rating Tools), an objective, evidence-based and easy-to-understand questionnaire about program design, planning, management, and performance. Objectivity is paramount to a PART rating. For example, when the development of the PART began in 2002, the first draft included a question relating to whether a particular program served an appropriate federal role. Because many people believed that the answer to that question would vary depending on the reviewer's philosophical outlook, the question was removed.

Public and private sector entities have reviewed the PART. Private sector reviewers have praised the PART assessment process for its transparency and objectivity and have also raised concerns that OMB has striven to address. For instance, some reviewers found assessments of different programs lack consistency in the answers to the same questions. OMB now audits all draft assessments to correct any obvious inconsistencies. Reviewers also found that agencies did not always agree with the final assessment of their programs. Agencies can now appeal to a high level subcommittee of the President's Management Council to dispute answers with which they disagree. To address concerns that OMB and agencies were not doing enough to involve Congress in the assessment process, agencies are now required to brief and consult their Congressional appropriators, authorizers, and overseers before the annual assessments begin.

The accompanying timeline provides a history of the development of 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. Agencies then identify and complete follow-up actions to improve program results.

To reflect the fact 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.) to facilitate comparison 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 the 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 disciplines established through the BPI Initiative. These agencies recognize that the PART can be a useful tool to drive improvement in the performance of their programs.

Agency success is judged by clear, Government-wide goals or standards for 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. To meet the Standards for Success for the BPI Initiative, an agency must:

- Demonstrate that senior agency managers meet at least quarterly to examine reports that integrate financial and performance information that covers all major responsibilities of the Department;
- Have 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;
- Report the full cost of achieving performance goals accurately in budget and performance documents and accurately estimate the marginal cost of changing performance goals;



- Have at least one efficiency measure for all PART-ed programs;
- Use PART evaluations to direct program improvements and hold managers accountable for those improvements, and PART findings and performance information are used consistently to justify funding requests, management actions, and legislative proposals; and
- Have less than 10 percent of agency programs receive a Results Not Demonstrated rating for two years in a row.

Each quarter, agencies receive 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 performance.

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, 2006, fifteen agencies achieved green status on the Budget and Performance Integration Initiative Scorecard. The agencies at green are:

1. Department of Agriculture
2. Department of Commerce
3. Department of Education
4. Department of Energy
5. Department of Justice
6. Department of Labor
7. Department of Transportation
8. Department of State
9. General Services Administration
10. National Aeronautics and Space Administration
11. National Science Foundation
12. Small Business Administration
13. Smithsonian
14. Social Security Administration
15. U.S. Agency for International Development

The Scorecard is an effective accountability tool to ensure agencies manage the performance of their pro-

grams. 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 [www.results.gov/agenda/scorecard.html](http://www.results.gov/agenda/scorecard.html).

### Broadcast Results on ExpectMore.gov

*ExpectMore.gov* provides Americans with candid information about which programs work, which do not, and what all programs are doing to get better every year.

Up until the launch of *ExpectMore.gov* last year, Americans had limited access to information on how well the Federal Government performed. Now, every American can see for themselves how their government is performing. In many cases, the Federal Government performs well. In some cases, it performs better than the private sector.

*ExpectMore.gov* contains PART summaries for all programs that have been assessed to date. The site provides the program information that 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 individuals interested in more information, the site also provides 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 help change that. The website has a variety of benefits, including:

- Increased public attention to performance;
- Greater scrutiny of agency action (or inaction) to improve program results:
  - Improvement plans will be transparent
  - Statements about goals and achievements will be clearer; and
- Demand for better quality and more timely performance data.

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# ExpectMore.gov

EXPECT FEDERAL PROGRAMS TO PERFORM WELL, AND BETTER EVERY YEAR.

The Federal Government is working to ensure its programs perform well. Here we provide you information about where we're successful and where we fall short, and in both situations, what we're doing to improve our performance next year.

Learn More ▶

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### Implement Inter-Agency Program Improvement

The Administration continues to look for new ways to improve the performance of programs with similar purposes or designs by using the PART to analyze performance across agencies (i.e., cross-cutting analysis) and State and local levels. 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 that all entities work 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 analysis of the government's math and science programs as part of the ACC (Academic Competitiveness Council).

*Academic Competitiveness Council.* The ACC set out to identify all Federal education programs with a science, technology, engineering, and math focus; clarify the goals of these programs; identify the extent to

which the programs have undergone independent, external evaluation based on sound, scientific principles and have quantitative evidence of achieving their goals; and identify better ways to measure and evaluate these programs and efficiently integrate and coordinate Federal spending on Science, Technology, Engineering, and Mathematics (STEM) education programs.

The ACC first identified 109 STEM education programs funded in 2006 for a total of \$3.13 billion. Within that total, elementary and secondary programs received approximately \$640 million (20 percent of the total), postsecondary programs, including graduate and postdoctoral programs, nearly \$2.4 billion (76 percent) and informal education and outreach programs close to \$103 million (4 percent). The group agreed on common goals for the programs, but found that few had been rigorously evaluated and determined to be effective. These programs, like many managed by the Federal Government, must do more to gather and report evidence of what activities are most effective at achieving common goals.

### 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 greater success in achieving the 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 achieve more with Americans' tax dollars.

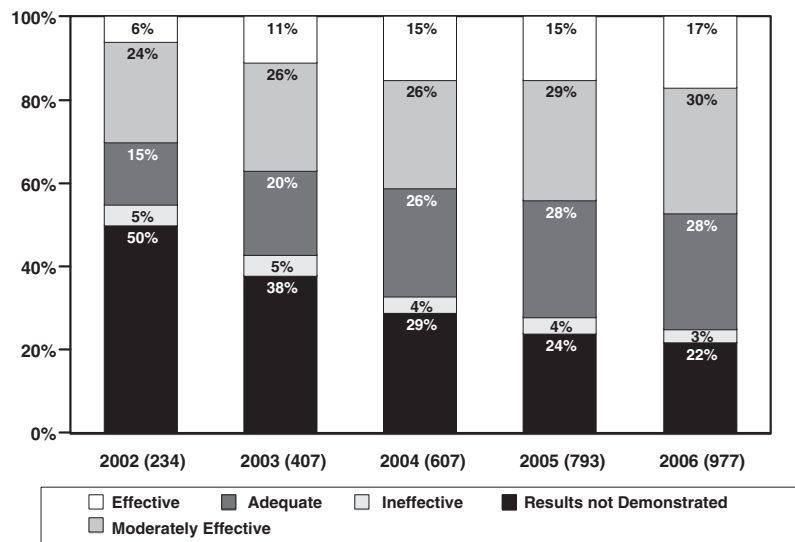
This marks the fifth year that the PART was used to (1) assess program performance, (2) take steps to improve program performance, and (3) help link performance to budget decisions. To date, the Administration has assessed nearly 1000 programs, representing approximately 96 percent of the Federal budget. 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 “Ade-

quate”. 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 Ratings Category



These results demonstrate that the BPI Initiative has been very successful in focusing Agencies’ attention on program performance. For example, approximately:

- 14 percent of programs improved their performance rating overall;
- 80 percent of programs have acceptable performance measures;
- 74 percent have achieved their long-term goals and 80 percent have achieved their annual goals; and
- 90 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 congressional 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 that include the relative priorities, costs, and risks associated with clusters of related programs, and reflect 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, building on the success of previous cross-cutting analyses. 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 web-based tool provides 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: [www.whitehouse.gov/omb/budget/fy2008/sheets/part.pdf](http://www.whitehouse.gov/omb/budget/fy2008/sheets/part.pdf). This table provides program ratings, section scores, funding levels, and other information. Additionally, a complete data file and data model of all assessments on ExpectMore.gov is available at: [www.whitehouse.gov/omb/expectmore/whatsnew.htm](http://www.whitehouse.gov/omb/expectmore/whatsnew.htm). This is a comma-separated values file that academics and researchers can use to analyze performance data.

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## CROSSCUTTING PROGRAMS

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### 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, identify and pursue terrorists abroad and implement 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 chemical, biological, radiological, and nuclear (CBRN) weapons; enhance the security of our borders, transportation modes and critical infrastructure; 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.

Underscoring 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. This analysis covers the homeland security funding and activities of all Federal agencies, not only those carried out by the Department of Homeland Security (DHS), but also addresses State, local, and private sector expenditures. Since not all activities carried out by DHS constitute homeland security funding (e.g., response to natural disasters, Coast Guard search and rescue activities), DHS estimates in this section do not represent the entire DHS budget.

#### Data Collection Methodology and Adjustments

The Federal spending estimates in this analysis utilize funding and programmatic information collected on the Executive Branch's homeland security efforts.<sup>1</sup> 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. Informa-

tion 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.<sup>2</sup> 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 homeland security-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.

#### Federal Expenditures

Total funding for homeland security has grown significantly since the attacks of September 11, 2001. For 2008, the President's Budget includes \$61.1 billion of gross budget authority for homeland security activities, a \$4.7 billion (8.4 percent) increase over the 2007 estimated level.<sup>3</sup> Not including the Department of Defense's (DOD) funding, the gross non-defense 2008 request for homeland spending is \$43.6 billion, or a \$3.8 billion (9.5 percent) increase over the 2007 estimated level. Excluding mandatory spending, fees, and the DOD's homeland security budget, the 2008 Budget proposes a net, non-Defense discretionary increase of \$3.4 billion (10.3 percent) over the 2007 level (see Table 3-1).

The 2008 Budget proposes homeland security funding for a total of 31 agencies. Of those, five agencies—the Departments of Homeland Security, Defense, Health and Human Services (HHS), Justice (DOJ) and Energy (DOE)—account for approximately 93 percent of total Government-wide homeland security funding in 2008.

<sup>1</sup>All data in the Federal expenditures section are based on the President's policy for the 2008 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.

<sup>2</sup>Federal homeland security activities are currently defined by OMB in Circular A-11 as, "activities that focus on combating and protecting against terrorism, and that occur within the United States and its territories (this includes Critical Infrastructure Protection (CIP) and Continuity of Operations (COOP) data), or outside of the United States and

its territories if they support domestically-based systems or activities (e.g., visa processing or pre-screening high-risk cargo at overseas ports). Such activities include efforts to detect, deter, protect against, and, if needed, respond to terrorist attacks."

<sup>3</sup>Aside from DHS and DOD, all other agencies' 2007 funding is at the estimated full-year Continuing Resolution levels. Further, the FY07 gross homeland security funding excludes supplemental and emergency funding received in 2007 (\$1.7 billion) and the Department of Commerce's mandatory borrowing authority for emergency communications interoperability grants (\$1 billion).

**Table 3-1. HOMELAND SECURITY FUNDING BY AGENCY**

(Budget authority, in millions of dollars)

Budget Authority	2006 Actual	2006 Supplemental/ Emergency	2007 Enacted/CR	2007 Supplemental/ Emergency <sup>1</sup>	2008 Request <sup>2</sup>
Department of Agriculture .....	597.4	.....	522.5	.....	718.5
Department of Commerce <sup>3</sup> .....	181.1	.....	194.1	.....	217.7
Department of Defense .....	16,479.3	1,030.5	16,538.3	.....	17,461.2
Department of Education .....	24.7	.....	24.0	.....	23.2
Department of Energy .....	1,702.1	.....	1,696.6	.....	1,833.9
Department of Health and Human Services .....	4,351.8	0.1	4,313.2	.....	4,424.1
Department of Homeland Security .....	25,154.9	1,416.1	26,872.2	1,816.4	29,666.5
Department of Housing and Urban Development .....	1.9	.....	1.9	.....	3.4
Department of the Interior .....	59.5	.....	46.8	.....	48.4
Department of Justice .....	2,995.4	30.3	3,089.3	96.0	3,330.5
Department of Labor .....	48.3	.....	49.4	.....	51.8
Department of State .....	1,107.9	.....	1,239.6	.....	1,405.7
Department of Transportation .....	181.0	.....	178.6	.....	200.0
Department of the Treasury .....	113.5	1.3	108.8	3.0	118.0
Department of Veterans Affairs .....	297.8	.....	243.6	.....	270.0
Corps of Engineers .....	72.0	.....	43.0	.....	42.0
Environmental Protection Agency .....	129.4	.....	132.9	.....	152.4
Executive Office of the President .....	20.8	.....	20.8	.....	20.8
General Services Administration .....	98.6	0.1	73.7	.....	42.3
National Aeronautics and Space Administration .....	212.6	.....	199.2	.....	193.9
National Science Foundation .....	344.2	.....	344.2	.....	375.4
Office of Personnel Management .....	2.7	.....	2.8	.....	2.3
Social Security Administration .....	176.4	.....	194.0	.....	217.1
District of Columbia .....	13.5	.....	8.0	.....	3.0
Federal Communications Commission .....	2.3	.....	2.3	.....	3.6
Intelligence Community Management Account .....	56.0	.....	56.0	.....	58.0
National Archives and Records Administration .....	18.2	.....	18.2	.....	18.1
Nuclear Regulatory Commission .....	79.3	.....	66.0	.....	68.9
Securities and Exchange Commission .....	5.0	.....	14.3	.....	18.3
Smithsonian Institution .....	83.7	.....	80.6	.....	92.8
United States Holocaust Memorial Museum .....	7.8	.....	7.8	.....	8.4
Corporation for National and Community Service .....	20.4	.....	20.4	.....	14.9
<b>Total, Homeland Security Budget Authority</b> .....	<b>54,639.4</b>	<b>2,478.4</b>	<b>56,403.0</b>	<b>1,915.4</b>	<b>61,104.9</b>
Less Department of Defense .....	-16,479.3	-1,030.5	-16,538.3	.....	-17,461.2
<b>Non-Defense Homeland Security Budget Authority, excluding Mandatory Interoperability Communications Grants <sup>4</sup></b> .....	<b>38,160.1</b>	<b>1,447.9</b>	<b>39,864.7</b>	<b>1,915.4</b>	<b>43,643.7</b>
Less Fee-Funded Homeland Security Programs .....	-3,512.9	.....	-4,396.4	.....	-4,986.2
Less Mandatory Homeland Security Programs .....	-2,256.9	.....	-2,487.7	.....	-2,291.0
<b>Net Non-Defense Discretionary Homeland Security Budget Authority, excluding Mandatory Interoperability Communications Grants <sup>4</sup></b> .....	<b>32,390.3</b>	<b>1,447.9</b>	<b>32,980.6</b>	<b>1,915.4</b>	<b>36,366.5</b>
Plus Mandatory Interoperability Communications Grants .....	.....	.....	1,000.0	.....	.....
<b>Net Non-Defense, Discretionary Homeland Security Budget Authority, including Mandatory Interoperability Communications Grants <sup>4</sup></b> .....	<b>32,390.3</b>	<b>1,447.9</b>	<b>33,980.6</b>	<b>1,915.4</b>	<b>36,366.5</b>
<b>Obligations Limitations</b>					
Department of Transportation Obligations Limitation .....	121.0	.....	121.0	.....	121.3

<sup>1</sup> The 2007 supplemental and emergency funding levels for the Departments of Homeland Security (DHS), Justice (DOJ), and Treasury include both enacted and requested supplemental funding. In the 2007 Global War on Terror (GWOT) supplemental request, DHS, DOJ, and Treasury request \$120 million, \$96 million, and \$3 million, respectively, for additional 2007 budget authority.

<sup>2</sup> The 2008 request levels for DHS and DOJ does not include additional budget authorities for 2008 requested in the 2007 GWOT supplemental request. Specifically, DHS and DOJ request \$225 million and \$85 million, respectively, in additional budget authority for 2008 to be provided in the 2007 GWOT supplemental appropriation bill.

<sup>3</sup> DOC's 2007 gross Continuing Resolution full-year estimate for homeland security excludes \$1 billion in mandatory borrowing authority to provide Federal grants to public safety agencies for communications interoperability purposes. Although technically scored in 2007, this funding will be made available from proceeds of the Federal Communications Commission's 2008 auction of returned television spectrum.

<sup>4</sup> The Deficit Reduction Act of 2005 appropriated \$1 billion from anticipated spectrum auction receipts for the Department of Commerce, in consultation with the Department of Homeland Security, to make grants to public safety agencies for communications interoperability purposes.

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 with many challenges. 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 between the Federal government and its State and local counterparts, 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*: intelligence and warning, border and transportation security, domestic counterterrorism, protecting critical infrastructures and key assets, defending against catastrophic threats, and emergency preparedness and response.

The *National Strategy* is a dynamic document being implemented through a robust interagency planning and coordination process. 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 changing 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 that suit the needs of the moment and at the same time align to long-term goals. For example, a major interagency effort currently occurring at the Federal level is the development of the National Implementation

Plan for the Global War on Terrorism and attendant performance measures that address homeland security.

Funding presented in this report is analyzed in the context of major “mission areas.” Activities in many of the mission areas are closely related and certain capabilities highlighted by a single mission area also enhance capabilities captured by other mission areas. 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 also address agents that represent catastrophic threats. However, for the purposes of segmenting Federal homeland security funding by mission areas, discussions of cross-cutting activities have also been separated by mission areas.

Furthermore, there are a small number of notable cross-cutting activities that are not specifically highlighted in any of the mission areas. For example, although pandemic influenza preparedness is considered an essential homeland security activity, it does not necessarily fit into a single mission area, and general bio-defense and preparedness activities of the Federal government encompass it. Nevertheless, the preparations we are making for pandemic influenza have a direct impact on our ability to defend against and respond to terrorist Weapons of Mass Destruction (WMD) threats.

The following table summarizes funding levels by the *National Strategy’s* mission areas; more detailed analyses are 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	2006 Actual	2006 Supplemental	2007 Enacted/CR	2007 Supplemental/ Emergency	2008 Request
Intelligence and Warning .....	443.0	6.3	500.3	13.0	647.9
Border and Transportation Security .....	18,042.3	1,335.8	19,528.1	1,816.4	22,403.8
Domestic Counterterrorism .....	4,535.6	89.8	4,980.3	83.0	4,889.4
Protecting Critical Infrastructure and Key Assets ..	17,933.2	862.4	17,919.7	3.0	19,096.1
Defending Against Catastrophic Threats .....	8,573.7	122.4	8,460.6	.....	8,828.9
Emergency Preparedness and Response .....	4,992.3	61.6	4,935.9	.....	5,022.0
Other .....	119.3	.....	78.1	.....	216.8
<b>Total, Homeland Security Budget Authority .....</b>	<b>54,639.4</b>	<b>2,478.4</b>	<b>56,403.0</b>	<b>1,915.4</b>	<b>61,104.9</b>
Plus Mandatory Interoperability Commu- nications Grants .....	.....	.....	1,000.0	.....	.....
<b>Total Homeland Security Budget Authority plus Mandatory Interoperability Commu- nications Grants .....</b>	<b>54,639.4</b>	<b>2,478.4</b>	<b>57,403.0</b>	<b>1,915.4</b>	<b>61,104.9</b>

### National Strategy Mission Area: Intelligence and Warning

The intelligence and warning mission area covers activities to detect terrorist threats and disseminate terrorist-threat information. This 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 2008, funding for intelligence and warning is distributed between DHS (60 percent), primarily in the Office of Intelligence and Analysis (I&A); DOJ (27 percent), primarily in the Federal Bureau of Investigation (FBI); and other Intelligence Community members (9 percent). The 2008 funding for intelligence and warning activities is 29.5 percent above the 2007 level.

**Table 3–3. INTELLIGENCE AND WARNING FUNDING**

(Budget authority, in millions of dollars)

Agency	2006 Actual	2006 Supplemental	2007 Enacted/CR	2007 Supplemental/Emergency	2008 Request
Department of Agriculture .....	5.2	.....	5.2	.....	22.3
Department of Commerce .....	.....	.....	1.8	.....	1.8
Department of Homeland Security .....	337.7	.....	380.1	.....	388.4
Department of Justice .....	41.7	5.0	54.8	10.0	173.8
Department of the Treasury .....	2.4	1.3	2.4	3.0	3.6
Intelligence Community Management Account .....	56.0	.....	56.0	.....	58.0
<b>Total, Intelligence and Warning .....</b>	<b>443.0</b>	<b>6.3</b>	<b>500.3</b>	<b>13.0</b>	<b>647.9</b>

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 (IRTPA) of 2004, the Director of National Intelligence (DNI) ensures that this office is setting collection and analysis priorities that are consistent with the *National Intelligence Strategy*. This 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.

In accordance with the IRTPA's requirements for the Information Sharing Environment (ISE), 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 DNI, in conjunction with the Homeland Security Council (HSC) and relevant Federal agencies, has established the ISE Implementation Plan and ISE Privacy

Guidelines in accordance with a Presidential directive in December, 2005, which outlined new guidelines and protocols for improving information sharing between Federal, State, local, and foreign governments and the private sector. The President has extended work on the ISE for another two years and fully supports the plan going forward to complete the ISE mandate as outlined in IRTPA.

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 with coordinating counterterrorism operational planning on a global basis and developing strategic, operational plans for the Global War on Terrorism. The NCTC, with guidance from the National Security Council and the HSC, has created the first National Implementation Plan for the Global War on Terrorism, which will further consolidate the U.S. Government's efforts on the Global War on Terrorism.

The DNI and the NCTC work to utilize the unique assets and capabilities of other Government agencies

and interagency groups—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 agencies' chains of command remain intact and prevent potentially excessive micromanagement of counterterrorism missions. Taken together, the creation of the NCTC and recent legislation and executive orders will ensure counterterrorism intelligence and warning assets are better allocated and more tightly coordinated, leading to improved intelligence for homeland security.

The 2008 budget request for the FBI supports improvements in its national security investigations and intelligence analysis, as well as technical and tactical support programs. Many of the improvements are targeted at FBI's National Security Branch, which integrates the Intelligence Directorate, Counterterrorism Division and Counterintelligence Division.

Over the past five 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, disseminate and utilize intelligence. The President's 2008 Budget supports the FBI's priorities and its continuing transformation by providing the resources needed to enhance its national security capabilities and improve supporting information technology and infrastructure. These initiatives will increase the number of agents and specialists working national security cases; enhance intelligence collection, systems, and training; improve IT systems that reduce paperwork and facilitate information sharing; and upgrade biometric identification systems to improve the identification of terrorists.

As a result of the Department of Homeland Security's 2006 re-organization (Second Stage Review), a new Office of Intelligence and Analysis was established to strengthen intelligence functions and information sharing within DHS. I&A gathers information to analyze terrorist threats to critical infrastructure, transportation systems, or other targets inside the homeland. Led by the DHS Chief Intelligence Officer reporting directly to the Secretary, this office not only relies on personnel from the former Information Analysis and Infrastructure Protection Directorate, but also 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.

I&A also serves as the focal point for disseminating homeland security information to State and local entities. For example, I&A is connected to homeland security directors of States, counties, and territories through the Homeland Security Information Network (HSIN) and it is deploying the Homeland Security Data Network (HSDN) to them as well. All fifty States and major urban areas are connected to HSIN, and HSIN is being rolled out to major counties as well. Furthermore, in recognition of the limitations of virtual interactions through electronic communications networks, beginning in late 2006, I&A has begun deploying liaisons and intelligence analysts to State and Local Intelligence Fusion Centers across the nation to improve the flow and quality of homeland security information to State, local and private sector partners and ensure a more accurate situational awareness for DHS and its Federal partners.

#### **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

**Table 3-4. BORDER AND TRANSPORTATION SECURITY FUNDING**

(Budget authority, in millions of dollars)

Agency	2006 Actual	2006 Supplemental	2007 Enacted/CR	2007 Supplemental/Emergency	2008 Request
Department of Agriculture .....	205.6	.....	210.2	.....	221.7
Department of Commerce .....	.....	.....	1.5	.....	1.6
Department of Energy .....	.....	.....	.....	.....	7.1
Department of Homeland Security .....	16,732.1	1,335.8	18,086.3	1,816.4	20,812.8
Department of Justice .....	30.4	.....	25.4	.....	4.6
Department of State .....	1,056.6	.....	1,188.3	.....	1,346.0
Department of Transportation .....	17.7	.....	16.4	.....	10.0
<b>Total, Border and Transportation Security .....</b>	<b>18,042.3</b>	<b>1,335.8</b>	<b>19,528.1</b>	<b>1,816.4</b>	<b>22,403.8</b>

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 (\$20.9 billion, or 93 percent, in 2008) is in DHS, largely for the U.S. Customs and Border Protection (CBP), the Transportation Security Administration (TSA), and the U.S. Coast Guard. Other DHS bureaus and other Federal Departments, such as the Departments of State and Justice, also play significant roles. The President's 2008 request would increase funding for border and transportation security activities by 6.7 percent over the 2007 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 layered 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 allowed for unification of the Federal Government's major border and transportation security resources, which 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.

The 2008 Budget provides approximately \$8.8 billion for the Border Patrol (an increase of 36 percent over 2007) including funding for 3,000 new agents. The President has committed to doubling the size of the Border Patrol to over 18,000 agents before he leaves office. At the start of the President's Administration, there were 9,096 Border Patrol agents. This Budget will bring the total number of agents to 17,819, and the next one will meet the President's goal. To gain control of our borders, the Budget also continues funding for fencing technology and other infrastructure along the border. For example, in September of 2006, DHS awarded a contract to implement the technological and infrastructure component of its Secure Border Initiative effort, SBInet. SBInet will concentrate on using proven technology to significantly improve the availability of information and tools to Border Patrol agents so they can better detect, identify, classify and confront illegal border activity by those who pose a threat to the United States. The Budget includes \$1 billion for this priority. This investment will support smarter and more secure borders.

The Administration has effectively ended the practice of "catch and release" along the northern and southern borders. Non-Mexican illegal aliens apprehended at the border are now detained and then returned to their home countries as quickly as possible and all non-criminal Mexicans apprehended for crossing the border illegally are returned to Mexico immediately. The 2008 Budget includes \$2.2 billion in detention and removal resources to continue this success and supports a total

of 28,450 detention beds across the country to house illegal aliens apprehended by DHS.

To improve coordination and provide assistance to State and local law enforcement officials, the Budget will expand a successful Federal, State and local partnership—the 287(g) program, which provides State/local law enforcement officials with guidance and training in immigration law, subject to the direction of the Secretary of Homeland Security. The 2008 Budget includes an increase of \$26 million for the 287(g) program and the Law Enforcement Support Center, including the training of 250 State and local law enforcement officers, detention beds for apprehended illegal aliens, and personnel to assist State and local law enforcement when they encounter aliens. The Budget also includes an increase of \$29 million to identify criminal aliens in Federal, State, and local prison facilities and remove those aliens from the United States, \$13 million for investigating smuggling and border criminal activity and \$5 million for identifying, apprehending, prosecuting and removing aliens involved in gang activities.

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. US-VISIT currently collects two digital fingerprints and a digital photograph of all foreign visitors entering the United States. The ability to screen foreign visitors against criminal and terrorist databases 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 ten fingerprints, allowing for improved accuracy in identifying foreign visitors and preventing the entry of known terrorists and criminals to the United States. DHS, in conjunction with the Departments of State and Justice, will implement this multiyear project to improve screening, and the 2008 Budget includes \$462 million for US-VISIT, of which \$228 million is for 10-print deployment and interoperability with the FBI's fingerprint system, the Integrated Automated Fingerprint Identification System.

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 has made significant improvements in aviation security since September 11<sup>th</sup> 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 2008 by requesting \$4 billion for aviation screening operations. TSA will also commit \$729 million to the purchase, installation, and maintenance of baggage screening devices, including inline systems that will increase baggage throughput up to

250 percent. The Budget also provides more than \$82 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, liquid bottle scanners, automated explosive sampling, and cast and prosthesis scanners.

Safeguarding 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 to the nation. 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 2008, the Coast Guard will continue to ensure compliance with MTSA port and vessel security standards and regulations. The 2008 Budget provides nearly \$3 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 2007, Congress passed P.L. 109-347, the SAFE Port Act, which requires enhanced screening of cargo bound for the United States, among other port security measures. In addition, port operators are eligible for grants to fund security enhancements under DHS' Infrastructure Protection Program (IPP) which falls 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 2008, the State Department will continue working with interagency partners to enable the transition of the US-VISIT program to a ten fingerprint system. For visitors that require a visa, the Department of State collects the visitor's biometric and biographic data, which is then checked against watch lists, thereby improving the abil-

ity to make a visa determination. When the visitor arrives in the United States, US-VISIT procedures allow DHS to determine whether the person applying for entry is the same person who was issued the visa by the Department of State. This and additional watch list checks improve the ability of DHS to make admissibility decisions.

In addition, the Department of State will also lead the implementation of the Western Hemisphere Travel Initiative in 2008, which mandates that all persons travelling internationally 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.

### 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: within DOJ (largely the FBI) and DHS (largely ICE), which account for 53.3 and 45 percent of total funding for 2008, respectively.

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.

**Table 3-5. DOMESTIC COUNTERTERRORISM FUNDING**

(Budget authority, in millions of dollars)

Agency	2006 Actual	2006 Supplemental	2007 Enacted/CR	2007 Supplemental/Emergency	2008 Request
Department of Homeland Security .....	2,127.0	65.0	2,482.8	.....	2,201.0
Department of Interior .....	0.3	.....	0.3	.....	0.3
Department of Justice .....	2,325.3	24.8	2,418.2	83.0	2,604.0
Department of Transportation .....	21.0	.....	20.0	.....	21.0
Department of the Treasury .....	60.7	.....	57.6	.....	61.7
Social Security Administration .....	1.4	.....	1.4	.....	1.4
<b>Total, Domestic Counterterrorism .....</b>	<b>4,535.6</b>	<b>89.8</b>	<b>4,980.3</b>	<b>83.0</b>	<b>4,889.4</b>

The President's 2008 Budget supports the FBI's top strategic priority: to protect the United States from terrorist attacks. FBI continues to build its counterterrorism capabilities post-September 11<sup>th</sup>. Over the past six years, FBI has shifted resources to counterterrorism from lower priority programs, hired and trained additional field investigators, enhanced science and technology capabilities, and strengthened headquarters oversight of the counterterrorism program. In addition, FBI has integrated its counterterrorism, counterintelligence, and intelligence functions by establishing the National Security Branch to oversee all three programs. More recently, the FBI has created a Weapons of Mass Destruction Directorate to coordinate all investigative and analytical efforts directed at WMD issues. Overall, FBI resources in the domestic counterterrorism category have increased from \$0.9 billion in 2002 to \$2 billion in 2008. Among the largest 2008 initiatives for enhancing counterterrorism capabilities are \$38 million to improve FBI's data intercept and access program, \$26 million to fund additional counterterrorism agents, and \$19 million to expand the WMD Directorate.

Within DHS, ICE focuses on a broad array of national security, financial, and smuggling violations, including illegal arms exports, financial crimes, commercial fraud, and human trafficking. The 2008 Budget provides \$2 billion 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 for two reasons: (1) the diversity of infrastructure and (2) the high level of private ownership (85 percent) of the Nation's key assets. DOD continues to

report the largest share of funding in this category for 2008 (\$12 billion, or 62.8 percent), which 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. Nevertheless, DHS has overall responsibility for prioritizing and executing infrastructure protection activities at the national level and accounts for \$3 billion (16 percent) of 2008 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 2008 request increases funding for activities to protect critical infrastructure and key assets by \$1.2 billion (6.6 percent) over the 2007 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 an 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.

Homeland Security Policy Directive 7 (HSPD-7), signed in December 2003, established a national policy to protect critical infrastructure and key resources from attack, to ensure the delivery of essential goods and services, and to maintain public safety and security. Under HSPD-7, DHS is responsible for coordinating Federal critical infrastructure programs and working closely with State and local governments and the private sector to align protection efforts. To provide the overall framework to integrate various critical infrastructure protection activities, DHS developed the Na-

**Table 3-6. PROTECTING CRITICAL INFRASTRUCTURE AND KEY ASSETS FUNDING**

(Budget authority, in millions of dollars)

Agency	2006 Actual	2006 Supplemental	2007 Enacted/CR	2007 Supplemental/ Emergency	2008 Request
Department of Agriculture .....	90.7	.....	31.1	.....	64.0
Department of Defense .....	11,150.5	862.3	11,254.0	.....	11,966.2
Department of Energy .....	1,520.6	.....	1,515.1	.....	1,607.1
Department of Health and Human Services .....	181.7	.....	184.8	.....	180.2
Department of Homeland Security .....	2,698.3	.....	2,779.6	.....	3,035.5
Department of Justice .....	541.1	.....	531.2	3.0	494.3
Department of Transportation .....	131.9	.....	131.9	.....	166.1
Department of Veterans Affairs .....	262.5	.....	208.3	.....	221.9
National Aeronautics and Space Administration ....	212.6	.....	199.2	.....	193.9
National Science Foundation .....	317.2	.....	317.2	.....	350.4
Social Security Administration .....	174.6	.....	191.9	.....	215.0
Other Agencies .....	651.7	0.1	575.4	.....	601.6
<b>Total, Protecting Critical Infrastructure and Key Assets .....</b>	<b>17,933.2</b>	<b>862.4</b>	<b>17,919.7</b>	<b>3.0</b>	<b>19,096.1</b>

tional Infrastructure Protection Plan (NIPP). The plan's risk-management approach provides the framework for government and industry to work together on common protective goals, while focusing resources where they are needed the most.

Recognizing that each infrastructure sector possesses its own unique characteristics, HSPD-7 also designated sector-specific agencies to coordinate infrastructure protection efforts within each sector. This approach enables agencies to rely on specialized expertise and long-standing relationships with industry in conducting infrastructure protection activities. There are 17 critical infrastructure sectors and 9 sector-specific agencies, including DHS. In December of 2006, DHS received the first set of sector-specific plans that address how each critical infrastructure sector will work together to collect infrastructure information, prioritize assets and protective programs, and develop metrics to inform future initiatives.

Although these efforts aimed at protecting critical infrastructure and key assets nationwide are in motion, the Administration has also been focusing on a select number of high-priority areas in parallel with NIPP implementation. For example, the 2008 Budget provides \$25 million to DHS to focus on chemical security regulation enforcement activities, such as requiring security vulnerability assessments and facility security plans and inspecting chemical facilities for compliance. The budget for the Environmental Protection Agency includes \$22 million in 2008 to begin testing the last of its pilot systems for the Water Security Initiative. The program develops pilot systems for cost effective, early warning of disease, pest, or poisonous agents in drinking water systems and offers subsequent consequence management. The Department of Agriculture also has completed extensive physical security assessments to make sure that agricultural physical security issues throughout the United States are in line with the latest best practices. Many other departments and agencies have critical infrastructure protection programs underway that support the mission of the NIPP and will benefit from the NIPP process.

DHS recently reorganized and combined its preparedness and response functions to fulfill requirements of the 2007 Homeland Security Appropriations Act. DHS also created the National Protection and Programs Directorate (NPPD), which includes offices that were omitted from the transfer to FEMA by statute. These offices, which focus on physical and cyber infrastructure protection, communications, as well as other major security initiatives, will be part of the newly created NPPD.

The Office of Infrastructure Protection (IP), located within this new directorate, is responsible for managing and prioritizing infrastructure protection at the national level. The Office operates the national asset database, which aggregates infrastructure data from across the nation. The database supports DHS in developing a risk-based strategy for protection and can be used to identify critical infrastructure under certain sce-

narios. IP also conducts site visits and assessments each year, and has used this information to develop site security guidelines for nuclear power plants and chemical facilities. The 2008 Budget provides \$240 million for these activities. In conjunction with funding for the Office of Infrastructure Protection, the Administration supports the Infrastructure Protection Program, which consists of five grant programs funding security enhancement projects in and around transportation assets and other critical infrastructure sites. Awarded through the Office of Grant Programs, IPP grants supplement State and local infrastructure security efforts, especially detection and prevention 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 (NCSA) 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. NCSA, now part of NPPD, works collaboratively with public, private, and international entities to secure cyberspace and America's cyber assets. NCSA 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.

NCSA also operates a Control Systems Security Program. Today, many critical infrastructures such as pipelines, water and pumping stations, and pharmaceutical production are run by computerized control systems. These systems make our critical infrastructure assets more automated, more productive, more efficient, and more innovative, but they also may expose those physical assets to cyber-related threats. NCSA works to address these weaknesses and enhance control systems security. To evaluate readiness and response programs such as the National Response Plan, NCSA has conducted 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 \$98 million for the NCSA in 2008.

### **National Strategy Mission Area: Defending Against Catastrophic Threats**

The defending against catastrophic threats mission area covers activities including research, development, and deployment of technologies, systems, and medical measures to detect and counter the threat of chemical, biological, radiological, and nuclear weapons. The agencies with the most significant resources to help develop and field technologies to counter CBRN threats are:

(1) DOD (\$5 billion, or 57.6 percent, of the 2008 total); (2) HHS, largely for research at the National Institutes of Health (NIH) (\$1.9 billion, or 22.1 percent, of the 2008 total); and (3) DHS (\$1.3 billion, or 14.5 percent,

of the 2008 total). The President's 2008 request would increase funding for activities to defend against catastrophic threats by \$368 million (4 percent) over the 2007 level.

**Table 3-7. DEFENDING AGAINST CATASTROPHIC THREATS FUNDING**

(Budget authority, in millions of dollars)

Agency	2006 Actual	2006 Supplemental	2007 Enacted/CR	2007 Supplemental/Emergency	2008 Request
Department of Agriculture .....	238.3	.....	226.0	.....	343.5
Department of Commerce .....	80.6	.....	88.7	.....	90.7
Department of Defense .....	4,988.5	122.0	4,889.8	.....	5,007.9
Department of Energy .....	62.1	.....	62.1	.....	63.2
Department of Health and Human Services .....	1,806.0	.....	1,848.5	.....	1,954.2
Department of Homeland Security .....	1,306.1	.....	1,255.1	.....	1,276.7
Department of Justice .....	37.4	0.5	40.0	.....	43.9
Department of the Treasury .....	.....	.....	.....	.....	1.8
National Science Foundation .....	27.0	.....	27.0	.....	25.0
Nuclear Regulatory Commission .....	27.8	.....	23.4	.....	21.9
<b>Total, Defending Against Catastrophic Threats</b>	<b>8,573.7</b>	<b>122.4</b>	<b>8,460.6</b>	.....	<b>8,828.9</b>

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

To protect against a nuclear or radiological weapon entering the country, the Domestic Nuclear Detection Office (DNDO) was created in 2005 within DHS to coordinate the Nation's nuclear detection efforts. DNDO, together with the Departments of State, Energy, Defense, and Justice, 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. DNDO 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 2008 Budget includes \$562 million for DNDO, a 17 percent increase from the 2007 level.

In 2008, DNDO will invest \$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. DNDO's budget also includes \$178 million for the deployment of both fixed and mobile radiation portal monitors at strategic points of entry throughout the

country. An additional \$30 million will be used to improve the detection of radiological and nuclear materials in and around the Nation's major urban areas under a program called Securing the Cities. 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.

To counter the threat of CBRN weapons, the Budget continues to invest in efforts to decrease the time between an attack and implementation of Federal, State and local response protocols. 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. DHS will therefore continue to support efforts such as 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. Beginning in 2008, DHS bio-defense programs such as BioWatch and biosurveillance will be consolidated in the newly established Office of Health Affairs. However, on-going research and development into next-generation bio-sensors that are able to better detect biological pathogens will continue in DHS's Science and Technology Directorate.

A key element in defending against catastrophic threats 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. The Budget continues HHS's investment in developing medical countermeasures to CBRN threats with \$1.9 billion in funding, which is more than \$1.8 billion over the level prior to September 11<sup>th</sup> (this includes funding for programs focused on chemical and radiological and nuclear countermeasures referenced below). For 2008, the Budget includes nearly \$190 million for the advanced development of medical countermeasures against threats of bioterrorism. Large investments in basic research of medical countermeasures at HHS 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 also continue to improve human health surveillance with \$88 million dedicated to biosurveillance activities, including the BioSense program (allowing local, State, and national public health authorities to monitor "real-time" trends in data from hospitals, emergency departments, and laboratories to identify and characterize potential human health threats), increasing laboratory capacity, and augmenting the number and quality of border health and quarantine stations. The Food and Drug Administration and the Department of Agriculture 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.

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 installation. Finally, the U.S. Northern Command, the military command responsible for DOD's homeland defense activities, is included in this category.

### 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 directly fall within the definition of a homeland security activity for funding purposes, as defined by Section 889 of the Homeland Security Act of 2002. 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.

HHS, the largest participant in this mission area (\$2.3 billion, or 48.4 percent, in 2008), 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 (\$1.5 billion, or 30.7 percent, for 2008), 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. The major requirements addressed in this mission area include:

**Table 3-8. EMERGENCY PREPAREDNESS AND RESPONSE FUNDING**

(Budget authority, in millions of dollars)

Agency	2006 Actual	2006 Supplemental	2007 Enacted/CR	2007 Supplemental/ Emergency	2008 Request
Department of Defense .....	340.4	46.2	394.5	.....	487.1
Department of Energy .....	119.4	.....	119.4	.....	156.3
Department of Health and Human Services .....	2,364.2	0.1	2,279.9	.....	2,289.7
Department of Homeland Security .....	1,842.9	15.3	1,821.6	.....	1,755.6
Other Agencies .....	325.4	.....	320.5	.....	333.3
<b>Total, Emergency Preparedness and Response ...</b>	<b>4,992.3</b>	<b>61.6</b>	<b>4,935.9</b>	<b>.....</b>	<b>5,022.0</b>
Plus Mandatory Communications Interoperability Grants .....	.....	.....	1,000.0	.....	.....
<b>Total, Emergency Preparedness and Response, including Mandatory Communications Interoperability Grants .....</b>	<b>4,992.3</b>	<b>61.6</b>	<b>5,935.9</b>	<b>.....</b>	<b>5,022.0</b>

- 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-hazards National Response Plan. The National Incident Management System was simultaneously developed to integrate a standardized Incident Command System throughout Federal, State and local response agencies and organizations. Additionally, the release of a unified National Preparedness Goal will provide 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 and enhancing 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 2007, the Federal Government has allocated over \$16 billion in State and local terrorism preparedness 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 \$2.9 billion in the 2008 request. The funding growth has been directed to Federal programs and grant assistance which support State and local preparedness and response activities, including equipping, training and exercising first responders, and preparing the public health infrastructure, for a range of terrorist threats. The Federal Government has taken steps to rationalize and simplify the distribution of State and local assistance; better target funds based on risk and effectiveness; and develop and implement the seven national priorities and 37 target capabilities identified in the National Preparedness Goal.

The 2008 Budget provides over \$100 million for DHS programs which train and exercise first responders in preparation for catastrophic events including the Na-

tional Exercise Program and the Center for Domestic Preparedness. In addition to these programs, DHS will provide grant funding to State and local agencies to support approximately 1,200 all-hazards preparedness exercises annually in 2007 and in 2008. The 2008 Budget also provides grants which support coordinated terrorism preparedness training and equipment for State and local responders across the various responder agencies. The 2008 request includes over \$1.5 billion for terrorism preparedness grants to be administered by the Office of Grant Programs within DHS, and proposes to continue current progress on the grant allocation process to better address threats and needs. In addition, to supplement assistance for public safety communications projects available through the DHS grants, the Department of Commerce, in consultation with DHS, will be awarding \$1 billion in additional grants for first responder communications interoperability to qualified applicants from anticipated spectrum auction receipts. The full outlay and impact of these funds will begin to be realized in FY 2008. 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, \$53 million for the National Disaster Medical System, 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.

In order to ensure that the nation is prepared for dealing with a biological attack, including pandemic influenza, the Administration continues to make significant investments in medical countermeasures through Project BioShield.<sup>4</sup> While the stockpiling of medical countermeasures is the primary goal, BioShield is also 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 that they are safe and effective enough to be added to the Strategic National Stockpile. As a result, this program also provides an incentive for the development and manufacturing of advanced countermeasures, ensuring that new and improved countermeasures will be available in the future. The Budget includes \$581 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.

Finally, HHS has the lead role in preparing public health providers for catastrophic terrorism. In addition to providing additional funding to expand HHS's public health and medical response capabilities, including disaster medical assistance, the 2008 Budget also provides

<sup>4</sup>BioShield is a shared responsibility, joining the intelligence capabilities of DHS with the medical expertise of HHS.

nearly \$414 million to continue improvements for hospital infrastructure and \$698 million 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 over \$9 billion.

### **Non-Federal Expenditures<sup>5</sup>**

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

<sup>5</sup>OMB does not collect detailed homeland security expenditure data from State, local, or private entities directly.

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.<sup>6</sup>

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.<sup>7</sup> 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 2008 Budget. The tables below present additional policy and baseline data, as directed by the Homeland Security Act of 2002.

<sup>6</sup>Source: National Association of Counties, "Homeland Security Funding—2003 State Homeland Security Grants Programs I and II."

<sup>7</sup>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	2006 Actual	2006 Supplemental	2007 Enacted/CR	2007 Supplemental/ Emergency	2008 Request
Department of Energy .....	1.9	.....	1.9	.....	3.3
Department of Homeland Security .....	2,422.0	.....	2,885.0	.....	3,319.0
Department of State .....	815.0	.....	1,166.7	.....	1,323.1
General Services Administration .....	91.8	.....	66.9	.....	34.3
Social Security Administration <sup>1</sup> .....	175.0	.....	193.3	.....	215.7
Federal Communications Commission .....	2.3	.....	2.3	.....	3.6
Nuclear Regulatory Commission .....	.....	.....	66.0	.....	68.9
Securities and Exchange Commission .....	5.0	.....	14.3	.....	18.3
<b>Total, Discretionary Homeland Security Fee-Funded Activities .....</b>	<b>3,512.9</b>	.....	<b>4,396.4</b>	.....	<b>4,986.2</b>

<sup>1</sup> Social Security physical and computer security measures are financed by amounts from the Social Security trust funds and payroll taxes.

**Table 3-10. MANDATORY HOMELAND SECURITY FUNDING BY AGENCY**

(Budget authority, in millions of dollars)

Agency	2006 Actual	2006 Supplemental	2007 Enacted/CR	2007 Supplemental/ Emergency	2008 Request
Department of Agriculture .....	177.4	.....	182.0	.....	194.5
Department of Commerce .....	14.1	.....	16.3	.....	18.3
Department of Energy .....	12.0	.....	12.0	.....	13.0
Department of Health and Human Services .....	16.6	.....	15.9	.....	14.3
Department of Homeland Security .....	2,032.8	.....	2,257.5	.....	2,042.2
Department of Labor .....	3.9	.....	3.9	.....	8.8
<b>Total, Homeland Security Mandatory Programs ....</b>	<b>2,256.9</b>	.....	<b>2,487.7</b>	.....	<b>2,291.0</b>
Plus Mandatory Communications Interoperability Grants .....	.....	.....	1,000.0	.....	.....
<b>Total, Homeland Security Mandatory Programs including Mandatory Communications Interoperability Grants .....</b>	<b>2,256.9</b>	.....	<b>3,487.7</b>	.....	<b>2,291.0</b>

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

(Budget authority, in millions of dollars)

Agency	2007 Enacted/ CR <sup>1</sup>	Baseline				
		2008	2009	2010	2011	2012
Department of Agriculture .....	523	545	559	574	587	602
Department of Commerce <sup>2</sup> .....	193	200	205	210	215	222
Department of Defense .....	16,538	17,064	17,569	18,077	18,591	19,110
Department of Education .....	24	25	25	26	26	27
Department of Energy .....	1,695	1,738	1,777	1,817	1,856	1,896
Department of Health and Human Services .....	4,313	4,422	4,532	4,640	4,752	4,853
Department of Homeland Security .....	28,572	29,562	30,549	31,508	32,480	33,466
Department of Housing and Urban Development .....	2	2	2	2	2	3
Department of the Interior .....	45	46	48	50	53	55
Department of Justice .....	3,090	3,210	3,327	3,446	3,566	3,694
Department of Labor .....	49	54	51	52	52	53
Department of State .....	1,239	1,268	1,299	1,327	1,354	1,380
Department of Transportation .....	179	187	193	202	210	219
Department of the Treasury .....	109	113	116	120	123	127
Department of Veterans Affairs .....	245	252	259	268	276	282
Corps of Engineers .....	43	44	45	46	47	48
Environmental Protection Agency .....	133	137	141	145	148	153
Executive Office of the President .....	20	20	21	21	22	23
General Services Administration .....	74	75	78	79	80	81
National Aeronautics and Space Administration .....	199	203	208	213	217	222
National Science Foundation .....	344	352	360	368	376	384
Office of Personnel Management .....	3	3	3	3	3	3
Social Security Administration .....	194	217	186	190	192	196
District of Columbia .....	8	8	8	9	9	9
Federal Communications Commission .....	2	2	2	2	2	2
Intelligence Community Management Account .....	56	57	59	60	61	62
National Archives and Records Administration .....	18	18	19	19	20	20
Nuclear Regulatory Commission .....	66	69	71	74	75	78
Securities and Exchange Commission .....	14	18	18	19	19	20
Smithsonian Institution .....	80	84	88	92	96	100
United States Holocaust Memorial Museum .....	8	8	8	8	9	9
Corporation for National and Community Service .....	20	20	21	21	21	22
<b>Total, Homeland Security Budget Authority .....</b>	<b>58,098</b>	<b>60,023</b>	<b>61,847</b>	<b>63,688</b>	<b>65,540</b>	<b>67,421</b>
Less Department of Defense .....	-16,538	-17,064	-17,569	-18,077	-18,591	-19,110
<b>Non-Defense Homeland Security Budget Authority, excluding Mandatory Interoperability Communications Grants and BioShield <sup>3</sup> .....</b>	<b>41,560</b>	<b>42,959</b>	<b>44,278</b>	<b>45,611</b>	<b>46,949</b>	<b>48,311</b>
Less Fee-Funded Homeland Security Programs .....	-4,397	-4,833	-4,909	-5,020	-5,124	-5,228
Less Mandatory Homeland Security Programs .....	-2,489	-2,290	-2,426	-2,531	-2,631	-2,735
<b>Net Non-Defense, Discretionary Homeland Security Budget Authority, excluding Mandatory Interoperability Communications Grants and BioShield <sup>3</sup> .....</b>	<b>34,674</b>	<b>35,836</b>	<b>36,943</b>	<b>38,060</b>	<b>39,194</b>	<b>40,348</b>
Plus Mandatory Communications Interoperability Grants .....	1,000	.....	.....	.....	.....	.....
Plus BioShield .....	.....	.....	2,175	.....	.....	.....
<b>Net Non-Defense, Discretionary Homeland Security Budget Authority, including Mandatory Interoperability Communications Grants and BioShield <sup>3</sup> .....</b>	<b>35,674</b>	<b>35,836</b>	<b>39,118</b>	<b>38,060</b>	<b>39,194</b>	<b>40,348</b>
<b>Obligations Limitations</b>						
Department of Transportation Obligations Limitation .....	121	124	126	130	133	135

<sup>1</sup> 2007 levels include enacted supplemental appropriations (\$1,696 million in DHS) but exclude GWOT supplemental requests in DHS, DOJ, and Treasury totaling \$219 million.<sup>2</sup> DOC's 2007 gross Continuing Resolution full-year estimate for homeland security excludes \$1 billion in mandatory borrowing authority to provide Federal grants to public safety agencies for communications interoperability purposes. Although technically scored in 2007, this funding will be made available from proceeds of the Federal Communications Commission's 2008 auction of returned television spectrum.<sup>3</sup> The Deficit Reduction Act of 2005 appropriated \$1 billion from anticipated spectrum auction receipts for the Department of Commerce, in consultation with the Department of Homeland Security, to make grants to public safety agencies for communications interoperability purposes.

## Estimates by Budget Function:

Table 3–12. HOMELAND SECURITY FUNDING BY BUDGET FUNCTION

(budget authority, in millions of dollars)

Agency	2006 Actual <sup>1</sup>	2007 Enacted/ CR <sup>2</sup>	2008 Request <sup>3</sup>
National Defense .....	22,056	20,463	21,359
International Affairs .....	1,107	1,239	1,406
General Science Space and Technology .....	616	602	635
Energy .....	124	106	122
Natural Resources and the Environment .....	288	264	292
Agriculture .....	581	506	679
Commerce and Housing Credit <sup>4</sup> .....	149	154	180
Transportation .....	8,186	9,161	9,453
Community and Regional Development .....	2,212	2,257	2,010
Education, Training, Employment and Social Services .....	177	174	179
Health .....	4,393	4,317	4,451
Medicare .....	12	15	14
Income Security .....	8	8	14
Social Security .....	175	193	216
Veterans Benefits and Services .....	299	245	270
Administration of Justice .....	15,917	17,792	18,941
General Government .....	816	821	890
<b>Total, Homeland Security Budget Authority .....</b>	<b>57,116</b>	<b>58,317</b>	<b>61,111</b>
Less National Defense, DoD .....	-17,508	-16,538	-17,465
<b>Non-Defense Homeland Security Budget Authority, excluding Mandatory</b>			
<b>Interoperability Communications Grants <sup>4</sup> .....</b>	<b>39,608</b>	<b>41,779</b>	<b>43,646</b>
Less Fee-Funded Homeland Security Programs .....	-3,509	-4,317	-4,899
Less Mandatory Homeland Security Programs .....	-2,257	-2,489	-2,290
<b>Net Non-Defense, Discretionary Homeland Security Budget Authority,</b>			
<b>excluding Mandatory Interoperability Communications Grants <sup>4</sup> .....</b>	<b>33,842</b>	<b>34,973</b>	<b>36,457</b>
Plus Mandatory Interoperability Communications Grants .....	.....	1,000	.....
<b>Net Non-Defense, Discretionary Homeland Security Budget Authority,</b>			
<b>including Mandatory Interoperability Communications Grants <sup>4</sup> .....</b>	<b>33,842</b>	<b>35,973</b>	<b>36,457</b>

<sup>1</sup> 2006 actual levels include enacted supplemental appropriations.<sup>2</sup> For 2007, only DOD and DHS have enacted appropriations; all other agencies' funding levels are based on their full-year CR rates. 2007 funding levels also include enacted supplemental appropriations (\$1,696 million) and requested 2007 supplemental budget authority (\$219 million) in the GWOT supplemental request.<sup>3</sup> DOC's 2007 gross Continuing Resolution full-year estimate for homeland security excludes \$1 billion in mandatory borrowing authority to provide Federal grants to public safety agencies for communications interoperability purposes. Although technically scored in 2007, this funding will be made available from proceeds of the Federal Communications Commission's 2008 auction of returned television spectrum.<sup>4</sup> The Deficit Reduction Act of 2005 appropriated \$1 billion from anticipated spectrum auction receipts for the Department of Commerce, in consultation with the Department of Homeland Security, to make grants to public safety agencies for communications interoperability purposes.

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

(Budget authority, in millions of dollars)

Budget Authority	2007 Enacted/ CR <sup>1</sup>	Baseline				
		2008	2009	2010	2011	2012
National Defense .....	20,264	20,897	21,508	22,120	22,738	23,364
International Affairs .....	1,239	1,268	1,299	1,327	1,354	1,380
General Science Space and Technology .....	602	616	630	644	657	672
Energy .....	106	111	112	116	117	121
Natural Resources and the Environment .....	264	271	279	287	295	304
Agriculture .....	506	528	541	555	568	583
Commerce and Housing Credit <sup>2</sup> .....	154	164	167	172	175	181
Transportation .....	9,161	9,537	9,832	10,132	10,438	10,745
Community and Regional Development .....	2,257	2,312	2,367	2,418	2,469	2,523
Education, Training, Employment and Social Services .....	174	179	186	192	197	204
Health .....	4,317	4,425	4,536	4,644	4,755	4,855
Medicare .....	15	16	16	17	18	19
Income Security .....	8	13	8	8	8	9
Social Security .....	193	216	185	189	191	195
Veterans Benefits and Services .....	245	252	259	268	276	282
Administration of Justice .....	17,775	18,379	19,057	19,712	20,375	21,053
General Government .....	818	839	865	887	909	931
<b>Total, Homeland Security Budget Authority .....</b>	<b>58,098</b>	<b>60,023</b>	<b>61,847</b>	<b>63,688</b>	<b>65,540</b>	<b>67,421</b>
Less National Defense, DoD .....	-16,538	-17,064	-17,569	-18,077	-18,591	-19,110
<b>Non-Defense, Discretionary Homeland Security Budget Authority, excluding Mandatory Interoperability Communications Grants and BioShield<sup>3</sup> .....</b>	<b>41,560</b>	<b>42,959</b>	<b>44,278</b>	<b>45,611</b>	<b>46,949</b>	<b>48,311</b>
Less Fee-Funded Homeland Security Programs .....	-4,397	-4,833	-4,909	-5,020	-5,124	-5,228
Less Mandatory Homeland Security Programs .....	-2,489	-2,290	-2,426	-2,531	-2,631	-2,735
<b>Net Non-Defense, Discretionary Homeland Security Budget Authority, excluding Mandatory Interoperability Communications Grants and BioShield<sup>3</sup> .....</b>	<b>34,674</b>	<b>35,836</b>	<b>36,943</b>	<b>38,060</b>	<b>39,194</b>	<b>40,348</b>
Plus Mandatory Communications Interoperability Grants .....	1,000	.....	.....	.....	.....	.....
Plus BioShield .....	.....	.....	2,175	.....	.....	.....
<b>Net Non-Defense, Discretionary Homeland Security Budget Authority, including Mandatory Interoperability Communications Grants and BioShield<sup>3</sup> .....</b>	<b>35,674</b>	<b>35,836</b>	<b>39,118</b>	<b>38,060</b>	<b>39,194</b>	<b>40,348</b>
<b>Obligations Limitations</b>						
Department of Transportation Obligations Limitation .....	199	203	208	213	217	222

<sup>1</sup> 2007 levels include enacted supplemental appropriations (\$1,696 million in DHS) but exclude GWOT supplemental requests in DHS, DOJ, and Treasury totaling \$219 million.

<sup>2</sup> DOC's 2007 gross full-year CR estimate for homeland security excludes \$1 billion in mandatory borrowing authority to provide Federal grants to public safety agencies for communications interoperability purposes. Although technically scored in 2007, this funding will be made available from proceeds of the Federal Communications Commission's 2008 auction of returned television spectrum.

<sup>3</sup> The Deficit Reduction Act of 2005 appropriated \$1 billion from anticipated spectrum auction receipts for the Department of Commerce, in consultation with the Department of Homeland Security, to make grants to public safety agencies for communications interoperability purposes.

### 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 2006, Federal statistical agencies improved their measures of the knowledge economy by releasing a preliminary Research and Development Satellite Account that estimates the effect of investment in research and development on U.S. economic growth (BEA and NSF); published, for the first time, estimates of households experiencing identity theft victimization and its consequences (BJS); developed procedures to ease the reporting burden of the 2007 Economic Census by enhanced electronic reporting, and to collect product data from all 350 service industries, up from 80 in the last census (Census Bureau); published data on the labor force status of persons who evacuated their homes due to Hurricane Katrina (BLS); developed and tested quality improvements to the Commodity Flow Survey, the

most comprehensive source of nationwide data on the transportation of goods (BTS and Census Bureau); introduced new interactive web-based tools to facilitate access to, and use of, health statistics information (NCHS); expanded internet data collection systems to securely process energy survey data more quickly and obtain better quality data (EIA); provided Internet access to forecasts of current year farm income (ERS); offered podcasts of farm broadcast news stories (NASS); and continued the modernization and reengineering of the decennial census to improve its accuracy and usefulness while containing costs (Census Bureau).

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 2008 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. Rel-

evance, 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. With the exception of cost indicators, where three agencies (ERS, NCES, and NCHS) are still planning their

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

Dimension	BEA	BJS	BLS	BTS	Census	EIA	ERS	NASS	NCES	NCHS	ORES	SOI	SRS
<b>Product Quality</b>													
Relevance	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Accuracy	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Timeliness	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
<b>Program Performance</b>													
Cost	✓	✓	✓	✓	✓	✓	P	✓	P	P	✓	✓	✓
Dissemination	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Mission	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Achievement	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
<div style="display: flex; justify-content: space-between; width: 100%;"> <span>✓ Indicator Available</span> <span>P Indicator Planned</span> </div>													

**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 = Science Resources Statistics Division, National Science Foundation

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 meet-

ing, its performance goals. The examples below illustrate different ways agencies track their performance on each dimension.

**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 non-sampling 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. Dissemina-

tion 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 pro-

duced 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 or units that are members of the ICSP, eleven agencies have programs that have been assessed using the PART process. All but one 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, in 2004 EIA received an initial rating of "Results Not Demonstrated" for two key reasons, both of which have since been rectified. At the time of the evaluation, EIA had recently adopted new performance measures and lacked the necessary historical baselines and future targets; these now exist for all measures. EIA was also critiqued for having no recurring independent evaluation of its entire program. EIA recruited an energy expert from the Massachusetts Institute of Technology to select and lead a team to conduct such an evaluation, and the team completed its report in 2006. EIA management will evaluate the team's recommendations as part of its strategic planning process in 2007. 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	
Criminal Justice Statistics Program	Effective
National Criminal History Improvement Program	Moderately Effective
Bureau of Labor Statistics	Effective
Bureau of Transportation Statistics	Moderately 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
Science Resources Statistics Division, NSF	
NSF's Infrastructure and Instrumentation component	Effective

### Highlights of 2008 Program Budget Proposals

The programs that provide essential statistical information for use by governments, businesses, researchers, and the public are carried out by more than 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 2008*, 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) extend the prototype Research & Development satellite account, funded by the National Science Foundation in 2006 and 2007, with annual updates and extensions to BEA’s Gross Domestic Product and other estimates between 2008 and 2012, and full incorporation into the economic accounts in 2013; (2) complete BEA’s five-year program to improve the accuracy and timeliness of the Nation’s economic accounts by addressing data gaps and measurement problems, expanding integration with other accounts, and improving consistency with international standards; and (3) continue to improve the accuracy of statistics on services, profits, compensation, international trade in services, and off-shoring.

**Bureau of Justice Statistics:** Funding is requested to provide for BJS’s core statistical programs and for two initiatives: (1) a redesign of the National Crime Victimization Survey based on anticipated recommendations from the Committee on National Statistics of the National Research Council; and (2) development of a national recidivism statistical series, which will provide baseline data, as well as representative data every 3 years, on the rates of rearrest, reconviction, and reincarceration among released State and Federal prisoners to provide a quantitative basis for evaluating the effectiveness of reentry programs, post-custody surveillance, and State policies related to parole revocation.

**Bureau of Labor Statistics:** Funding is requested to support the production, dissemination, and improvement of BLS economic measures, including: (1) the introduction of continuous updating to the housing and geographic area samples in the Consumer Price Index (CPI), which will improve the accuracy and timeliness of the CPI; (2) the continuation of efforts 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) the publication, for the first time, of local area Employment Cost Index (ECI) and *Employer Costs for Employee Compensation* (ECEC) series as deemed feasible as a result of testing completed in 2007.

**Bureau of Transportation Statistics:** Funding is requested to: (1) conduct the Commodity Flow Survey, a major national benchmark survey of shippers; (2) release monthly statistics on the commodities and mode of transportation used in trading with our largest partners; (3) produce a core set of economic data and indicators, including the Government Transportation Financial Statistics Report, multi-factor productivity measures, the State Transit Expenditure Survey, and the Air Travel Price Index; (4) produce and release the National Transportation Atlas Data Base, a compendium of national geospatial transportation data; and (5) conduct the biennial Census of Ferry Operations in the U.S.

**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) collect and process economic census returns for the 2007 Economic Census; (2) create the universe frame and develop organizational information for the 2007 Census of Governments, as well as collect and process data for the employment phase, and collect and process data from States and other sources for the finance phase; (3) undertake an initiative to close the current gap in service sector coverage; and (4) continue reengineering the Survey of Income and Program Participation. For the 2010 Census program, funding is requested to continue to: (1) conduct planning, testing, and development activities to support a re-engineered 2010 Census, including the 2008 Census Dress Rehearsal and early operations for the 2010 Census; (2) improve the accuracy of map feature locations for the remaining 367 counties of the total of 3,232 counties; and (3) continue to conduct the American Community Survey to provide socio-economic data on an ongoing basis rather than only once-a-decade.

**Economic Research Service:** Funding is requested to: (1) strengthen and enhance the ERS market analysis and outlook program to provide timely analysis of global agricultural product markets; and (2) strengthen ERS’s research and modeling capacity in the area of bio-energy with particular emphasis given to the changing economics of livestock feeding and the role of ethanol byproducts.

**Energy Information Administration:** Funding is requested to continue ongoing operations to: (1) maintain critical energy data coverage, analysis, and forecasting; (2) improve data reliability and statistical accuracy through redesigning key petroleum and natural

gas surveys; (3) initiate monthly ethanol and biofuels data collections on a national and regional basis as mandated in Section 1508 of the *Energy Policy Act of 2005*; (4) strengthen global oil and gas data and modeling capabilities; and (5) improve the ability to assess and forecast supply, demand, and technology trends affecting U.S. and world energy markets.

**National Agricultural Statistics Service:** Funding is requested to support printing, postage and handling of questionnaire packages, logging returned questionnaires, capturing reported data, and conducting telephone and personal follow-up interviews with non-respondents for the quinquennial Census of Agriculture via questionnaires that are scheduled to be mailed to the Nation's agricultural producers in December 2007.

**National Center for Education Statistics:** Funding is requested to: (1) conduct the National Assessment of Educational Progress, including 12th grade reading and mathematics assessments in 2009; (2) plan for a new high school longitudinal study that will begin with a cohort of 9th graders in 2009 and follow them through postsecondary education and into the workforce; (3) analyze data from international studies such as the 2007 Trends in International Mathematics and Science Study and plan for new international assessments; (4) undertake a pilot study on the development of postsecondary unit records, an essential restructuring of several components of the Integrated Postsecondary Education Data System; (5) carry out the 2007–08 Schools and Staffing Survey to obtain information on public and private schools, principals, and teachers; and (6) conduct the Beginning Postsecondary Student Longitudinal Survey, which provides information on the progress of postsecondary students, as well as the 2008 National Postsecondary Student Aid Survey.

**National Center for Health Statistics:** Funding is requested to: (1) continue data collection, analysis, and dissemination 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) continue efforts to develop survey data

that address the health care delivery system; and (4) 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 strategic planning to modernize ORES's processes for developing and disseminating data from the Social Security Administration's major administrative data files for statistical purposes; (2) support outside surveys and linkage of 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 analytic validity of a synthetic data file based on data from the 1990–1993 and 1996 Survey of Income and Program Participation (SIPP) panels matched to SSA and IRS administrative data.

**Science Resources Statistics Division, NSF:** Funding is requested to: (1) implement ongoing programs on the science and engineering enterprise; (2) continue to implement redesign and improvement activities for a broad range of surveys, particularly the suite of research and development (R&D) surveys; (3) support the NSF/SBE initiative on the Science of Science and Innovation Policy to develop the data, tools, and knowledge needed for a new science of science policy by enhancing the comparability, scope and availability of international data; and (4) develop data on innovation and R&D conducted or funded by nonprofit organizations.

**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](http://www.irs.gov/taxstats) website.

**Table 4-1. 2006-2008 BUDGET AUTHORITY FOR PRINCIPAL STATISTICAL AGENCIES<sup>1</sup>**

(In millions of dollars)

	2006 Actual	Estimate	
		2007	2008
Bureau of Economic Analysis .....	75	75	81
Bureau of Justice Statistics <sup>2</sup> .....	50	50	62
Bureau of Labor Statistics .....	537	537	573
Bureau of Transportation Statistics .....	27	27	27
Census Bureau <sup>3</sup> .....	822	817	1250
Salaries and Expenses <sup>3</sup> .....	216	210	223
Periodic Censuses and Programs .....	606	607	1027
Economic Research Service <sup>4</sup> .....	75	75	83
Energy Information Administration .....	85	85	105
National Agricultural Statistics Service <sup>5</sup> .....	139	140	168
National Center for Education Statistics .....	183	183	236
Statistics .....	90	90	119
Assessment .....	88	88	111
National Assessment Governing Board .....	5	5	6
National Center for Health Statistics <sup>6</sup> .....	109	109	110
Office of Research, Evaluation, and Statistics, SSA .....	16	18	15
Science Resources Statistics Division, NSF .....	33	33	37
Statistics of Income Division, IRS .....	38	41	41

<sup>1</sup> Reflects any recissions.<sup>2</sup> Includes funds for management and administrative costs of \$11, \$11, and \$17 million in 2006, 2007, 2008, respectively that were previously displayed separately.<sup>3</sup> 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 Children's Health Insurance Program funds.<sup>4</sup> 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.<sup>5</sup> Includes funds for the periodic Census of Agriculture of \$29, \$29, and \$54 million in 2006, 2007, and 2008, respectively. The FY 2008 Budget includes an increase of \$24.7 million due to cyclical activities.<sup>6</sup> 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.





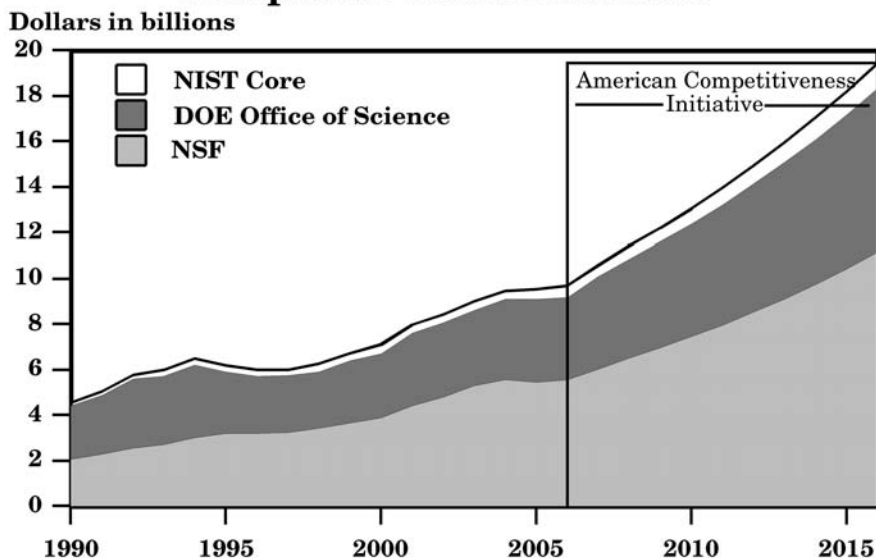
## 5. RESEARCH AND DEVELOPMENT

The U.S. economy is the largest in the world, and has been growing faster than any other G-7 industrialized nation. In large measure, the U.S. economy owes its strength 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 improve our understanding of the world. Economists estimate that as much as half of post-World War II economic growth is directly due to technological progress fueled by research and development (R&D).

Economic payoffs from 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.

To sustain the Nation's economic competitiveness, the President, in last year's State of the Union address, called for a long-term vision to strengthen Federal support for the Nation's innovation enterprise in an integrated package of investments and policies called the American Competitiveness Initiative (ACI).

**Chart 5-1. Research in the American Competitiveness Initiative**



### I. THE AMERICAN COMPETITIVENESS INITIATIVE

The President's 2008 Budget maintains a strong commitment, through the ACI, to invest in basic research areas that advance knowledge and technologies used by scientists in nearly every field. Through the ACI, the President 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 2008, the second year of the American Competitiveness Initiative, President Bush proposes \$11.4 billion total for NSF, DOE's Office of Science, and NIST laboratories, an overall funding increase of \$764 million, or 7.2 percent, above his 2007 Budget of \$10.7 billion. 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 basic research in areas such as nanotechnology, advanced networking and information technology, physics, chemistry, materials science, mathematics, and engineering. It also is well regarded for funding nearly all of its research through a competitive, peer-reviewed process. The increase in NSF funding will support many more 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. The 2008 Budget increases funding for both research and cutting edge facilities in these critical mission areas, such as an expansion in the number of bio-energy research centers, major growth in the United States' contribution to the international fusion energy project known as ITER, expanded supercomputing facilities and related research, and design or construction activities for world-leading next generation light sources.

The Department of Commerce's National Institute of Standards and Technology invests in technological innovation through research and standards development. These investments will improve nanotechnology manufacturing capabilities; expand NIST's neutron facility to aid in characterizing novel materials in high-growth research fields; construct new, high-performance laboratories at NIST's Boulder, Colorado facility; and improve our understanding of quantum information science that has the potential to dramatically improve computer processing speeds and enable more secure communications.

## 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 develop-

ment 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.

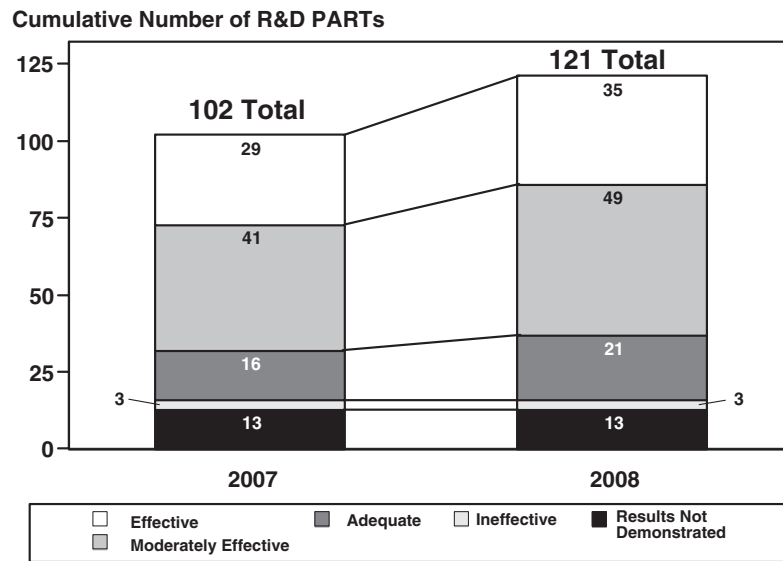
In addition, R&D projects and programs relevant to industry are expected to apply criteria to determine the appropriateness of the public investment, enable comparisons of proposed and demonstrated benefits, and provide meaningful decision points for completing or transitioning the activity to the private 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 five years, agencies completed 977 PART assessments, of which 121 were for R&D programs. The results of these PART assessments may be found on the web at [www.expectmore.gov](http://www.expectmore.gov).

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. While programs rated Effective are typically favored for additional funding over related programs that do not perform as well, PART ratings do not automatically

relate to specific funding levels. For instance, a program rated Effective that has achieved what it set out to do may have its funding reduced. On the other hand, a program rated Ineffective might receive more money to correct a deficiency that would help it become more effective. The PART provides information that leads to more informed decisions.

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



### Research Earmarks

President Bush has called on Congress to reform the earmark process, proposing a series of reforms that include full disclosure for each earmark and cutting the number and cost of all earmarks by at least half. Consistent with this effort, the Administration is continuing its strong support for awarding research funds based on merit review through a competitive process refereed by scientists themselves. 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. 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. For example, the Defense Advanced Research Projects Agency, within the Department of Defense (DOD), seeks out high-risk, high-payoff scientific proposals, the National Institutes of Health has established a similarly focused “Pioneer Award,” 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 diabetes, neurofibromatosis (a genetic disorder of the nervous system), and childhood cancer. Congressional adds in DOD’s budget for medical research projects totals about \$500 million in 2007 alone.

While research on these diseases is very important, these diseases are generally not unique to the U.S. military and the research 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 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 an approach that should be followed throughout the R&D programs.

### III. PRIORITIES FOR FEDERAL RESEARCH AND DEVELOPMENT

The 2008 Budget requests \$143 billion for Federal R&D funding, and targets key research investments within agencies, in particular, the three ACI agencies: NSF, the DOE's Office of Science, and the NIST laboratories. (Table 5-1 provides details by agency).

#### Multi-Agency R&D Priorities

The 2008 Budget continues to target important research investments that must be coordinated across multiple agencies. 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:** A robust R&D effort continues to be a key asset in advancing technologies in support of the President's national strategy for homeland security. Though there have been numerous achievements over the past four years, many challenges remain. A number of these challenges are being addressed through multi-agency research efforts that are coordinated through the National Science and Technology Council (NSTC) and other inter-agency forums.

In 2006, key multi-agency R&D efforts made significant progress towards improving the Nation's counterterrorism capability. Using the 2006 Administration R&D budget priorities memorandum as a guide, agencies, for example:

- improved radiation portal monitors with the ability to discern threatening sources of radiation from non-threatening sources;
- advanced technology to meet new international electronic passport standards that enables biometric screening of individuals entering the country;
- developed standards for technologies that enable the detection and interception of nuclear and radioactive material before it enters the U.S.;
- developed and established standard methodologies and practices for the sampling and detection of biological agents; and
- developed rapid diagnostics and next generation vaccines.

The 2008 Budget provides continued support for these and many other R&D related to combating terrorism, including: pursuing stand-off detection and imaging capabilities to locate and identify nuclear threat materials at a distance; advancing cargo screening capabilities to recognize and expedite safe cargo while securing the

borders against other entries; improving the capabilities and implementation planning of biometric systems; initiating the 2008-2012 R&D plan for high-consequence foreign animal diseases; and focusing on critical medical countermeasures that do not have a pre-existing market to stimulate their development.

**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, cyber security, large-scale networking, software development, high-confidence systems, information management, 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 2006, 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 2008 Budget continues the path toward the development of petascale systems for science by both DOE and NSF. Relevant agencies will continue to conduct research in highly scalable systems software and applications to ensure that Federal investments in high-end computing achieve maximal impact.

Participating agencies also completed and published the Federal Plan for Cyber Security and Information Assurance R&D in 2006, and are now undertaking the development of the roadmap for addressing any identified R&D gaps as recommended in the Plan.

In 2007, participating agencies will undertake the development of a Federal Plan for Advanced Networking R&D, analogous to the recent Plans for High-End Computing and for Cyber Security and Information Assurance R&D. The Federal Plan for Advanced Networking R&D will provide a strategy for addressing current and future networking needs of the Federal government in support of science and national security missions, and provide a process for developing a more detailed roadmap to guide future multi-agency investments in advancing networking R&D. Reports and general information about NITRD are available at [www.nitrd.gov/](http://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. Research opportunities cover a similarly broad spectrum. Advances that will be foundational for all aspects of nanotechnology R&D in particular include: instrumentation for characterizing nanoscale materials in the laboratory, in the body, and in the environment; and computational research to model and predict properties at the nanoscale, for designing novel materials, and for determining their behavior under various conditions and environments.

Guided by the NNI, participating agencies will continue to support discovery, development and application of nanotechnology through investigator-led fundamental and applied research; multidisciplinary centers of excellence; education and training of nanotechnology researchers, teachers, workers, and the public; and infrastructure development, including user facilities and networks that are broadly available to support research and innovation. 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/](http://www.nano.gov/).

**Climate Change R&D:** The 2008 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 the CCSP coordinate preparation of the budget and program implementation. During 2008, the CCSP will continue research into important scientific uncertainties and preparation of a series of *Synthesis and Assessment* reports. Working within the overarching priorities defined in the Strategic Plan, the CCSP's interagency coordination and integration efforts will give particular emphasis in 2008 to the following activities: abrupt climate change; integrated Earth system analysis; coping with drought through research and regional partnerships; integration of water cycle observations, research and modeling; carbon cycle research integration; aerosol forcing and interactions with clouds and non-carbon dioxide trace gases; impacts of climate variability and change on ecosystem productivity and biodiversity; and interactions on land use/land cover change and climate.

The program expects to receive input from the National Research Council under the terms of a continuing advisory agreement. This advice will include findings and recommendations on the process for evaluating progress toward the five goals in the CCSP Strategic

Plan, and a preliminary assessment of progress made toward the program's goals. The 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 2008 edition of *Our Changing Planet*. Reports and general information about the CCSP are available on the program's website: [www.climateescience.gov/](http://www.climateescience.gov/).

The Climate Change Technology Program (CCTP) continues to provide strategic direction, planning, and analysis 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 addressed the nearly 300 comments received and published 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. In 2008, CCTP's focus will be on implementing the Strategic Plan, which lays out a series of next steps. Reports and general information about the CCTP are available on the program's website: [www.climateetechology.gov/](http://www.climateetechology.gov/).

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

**Ocean Research:** The 2008 Budget supports ocean and coastal research as outlined in the recently released report *Charting the Course for Ocean Science in the United States for the Next Decade: An Ocean Research Priorities Plan and Implementation Strategy*. Developed by the National Science and Technology Council's Joint Subcommittee on Ocean Science and Technology, plan implementation will deploy key components of an ocean observing system that can better and more accurately describe actual conditions, enhance our understanding and capability to forecast ocean processes and phenomena, and provide scientific support for ecosystem-based management. These three overarching goals represent tremendous potential for ocean science, as well as for maintaining U.S. leadership in ocean technology and enhancing U.S. competitiveness. These goals are supported by 20 separate national ocean research priorities, established with extensive community input and oriented around the most compelling issues of interaction between society and the ocean. The Joint Subcommittee on Ocean Science and Technology will coordinate this multi-agency research into key aspects of the oceans, coasts and Great Lakes and work closely with the other coordinating bodies of the President's Ocean Action Plan.

**Hydrogen R&D:** In 2006, the Hydrogen R&D Inter-agency Task Force led coordination among nine agen-

cies in hydrogen-related manufacturing and innovation, safety, codes and standards, and fundamental research on fuel cells, hydrogen production, and hydrogen storage. The Task Force improved and updated its web portal ([www.hydrogen.gov](http://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 to lead the President's Hydrogen Fuel Initiative to accelerate the worldwide availability and affordability of hydrogen-powered fuel cell vehicles and the infrastructure to support them. The initiative focuses on research to advance hydrogen production, storage, conversion, and infrastructure technologies. The 2008 Budget completes the President's five-year, \$1.2 billion commitment announced in his 2003 State of the Union address, but work will continue on the many technical challenges that remain.

**Biomass R&D:** The Biomass R&D Act of 2000 established the Biomass R&D Board to guide interagency coordination and bring coherence to Federal strategic planning on biomass-related issues. Since 2002, the Departments of Agriculture and Energy have been preparing joint annual reports on a subset of coordinated biomass activities. In 2006, the Board began preparation of an interagency coordination and planning docu-

ment that will be reviewed by the National Academy of Sciences. In addition to assessing the goals and plans for interagency biomass research, the Academy will be tasked with considering economic and other impacts of increased biomass utilization under various energy price and policy scenarios. Additional information on the Biomass R&D Board is available online at [www.biomass.govtools.us](http://www.biomass.govtools.us).

### 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, which had provided a 20-percent tax credit for private research and experimentation expenditures above a certain base amount, was extended for two years through the end of 2007 and enhanced through the Tax Relief and Health Care Act of 2006. The Administration proposes making the enhanced Research and Experimentation tax credit permanent starting in 2008. The proposed extension will cost \$42 billion over the period from 2008 to 2012. 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 systematic study directed toward a fuller knowledge or understanding of the fundamental aspects of phenomena and of observable facts without specific applications towards processes or products in mind. Basic research, however, may include activities with broad applications 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 or understanding, directed 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, research satellites, detectors, and other instruments. At a minimum, this cat-

egory should include programs devoted to the purchase or construction of R&D equipment.

**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.

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 the overall R&D data. 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 2008 Budget requests \$61 billion for FS&T.

**Table 5-1. FEDERAL RESEARCH AND DEVELOPMENT**

(Budget authority, dollar amounts in millions)

	2006 Actual	2007 Estimate	2008 Proposed	Dollar Change: 2007 to 2008	Percent Change: 2007 to 2008
<b>By Agency</b>					
Defense .....	73,723	77,881	78,862	981	1%
Health and Human Services .....	28,531	28,743	29,027	284	1%
NASA .....	11,317	11,613	12,428	815	7%
Energy .....	8,596	8,389	9,224	835	10%
National Science Foundation .....	4,227	4,232	4,880	648	15%
Agriculture .....	2,438	2,316	2,010	-306	-13%
Commerce .....	1,090	920	1,088	168	18%
Homeland Security .....	1,455	1,079	1,068	-11	-1%
Veteran Affairs .....	824	818	822	4	0%
Transportation .....	820	752	812	60	8%
Interior .....	639	636	621	-15	-2%
Environmental Protection Agency .....	622	567	562	-5	-1%
Other .....	1,250	1,223	1,251	28	2%
<b>Total</b> .....	<b>135,532</b>	<b>139,169</b>	<b>142,655</b>	<b>3,486</b>	<b>3%</b>
<b>Basic Research</b>					
Defense .....	1,457	1,565	1,428	-137	-9%
Health and Human Services .....	15,546	15,545	15,615	70	0%
NASA .....	2,299	2,259	2,226	-33	-1%
Energy .....	2,930	2,957	3,409	452	15%
National Science Foundation .....	3,520	3,499	3,993	494	14%
Agriculture .....	853	799	771	-28	-4%
Commerce .....	118	118	164	46	39%
Homeland Security .....	85	105	132	27	26%
Veteran Affairs .....	343	328	330	2	1%
Transportation .....					N/A
Interior .....	42	42	39	-3	-7%
Environmental Protection Agency .....	105	94	94		
Other .....	158	163	170	7	4%
<b>Subtotal</b> .....	<b>27,456</b>	<b>27,474</b>	<b>28,371</b>	<b>897</b>	<b>3%</b>
<b>Applied Research</b>					
Defense .....	4,948	5,330	4,357	-973	-18%
Health and Human Services .....	12,827	12,964	13,237	273	2%
NASA .....	1,680	1,010	1,127	117	12%
Energy .....	2,700	2,707	2,869	162	6%
National Science Foundation .....	286	281	380	99	35%
Agriculture .....	1,149	1,117	984	-133	-12%
Commerce .....	729	617	696	79	13%
Homeland Security .....	662	518	533	15	3%
Veteran Affairs .....	435	442	444	2	0%
Transportation .....	497	501	541	40	8%
Interior .....	546	534	525	-9	-2%
Environmental Protection Agency .....	400	369	364	-5	-1%
Other .....	590	549	581	32	6%
<b>Subtotal</b> .....	<b>27,449</b>	<b>26,939</b>	<b>26,638</b>	<b>-301</b>	<b>-1%</b>
<b>Development</b>					
Defense .....	67,154	70,926	72,873	1,947	3%
Health and Human Services .....	22	22	22		
NASA .....	5,141	6,451	6,707	256	4%
Energy .....	1,939	1,843	1,891	48	3%
National Science Foundation .....					N/A
Agriculture .....	164	158	156	-2	-1%
Commerce .....	93	55	72	17	31%
Homeland Security .....	659	325	269	-56	-17%
Veteran Affairs .....	46	48	48		
Transportation .....	305	232	252	20	9%
Interior .....	46	53	55	2	4%
Environmental Protection Agency .....	117	104	104		
Other .....	464	455	454	-1	0%
<b>Subtotal</b> .....	<b>76,150</b>	<b>80,672</b>	<b>82,903</b>	<b>2,231</b>	<b>3%</b>
<b>Facilities and Equipment</b>					
Defense .....	164	60	204	144	240%
Health and Human Services .....	136	212	153	-59	-28%

**Table 5-1. FEDERAL RESEARCH AND DEVELOPMENT—Continued**

(Budget authority, dollar amounts in millions)

	2006 Actual	2007 Estimate	2008 Proposed	Dollar Change: 2007 to 2008	Percent Change: 2007 to 2008
NASA .....	2,197	1,893	2,368	475	25%
Energy .....	1,027	882	1,055	173	20%
National Science Foundation .....	421	452	507	55	12%
Agriculture .....	272	242	99	-143	-59%
Commerce .....	150	130	156	26	20%
Homeland Security .....	49	131	134	3	2%
Veteran Affairs .....					N/A
Transportation .....	18	19	19		N/A
Interior .....	5	7	2	-5	-71%
Environmental Protection Agency .....					N/A
Other .....	38	56	46	-10	-18%
<b>Subtotal .....</b>	<b>4,477</b>	<b>4,084</b>	<b>4,743</b>	<b>659</b>	<b>16%</b>



**Table 5-2. FEDERAL SCIENCE AND TECHNOLOGY BUDGET**  
(Budget authority, dollar amounts in millions)

	2006 Actual	2007 Estimate <sup>1</sup>	2008 Proposed	Dollar Change: 2007 to 2008	Percent Change: 2007 to 2008
<b>By Agency</b>					
<b>National Institutes of Health<sup>2</sup></b> .....	<b>28,242</b>	<b>28,269</b>	<b>28,700</b>	<b>431</b>	<b>2%</b>
<b>NASA<sup>3</sup></b> .....	<b>7,670</b>	<b>7,173</b>	<b>7,124</b>	<b>-49</b>	<b>-1%</b>
Science .....	5,110	5,330	5,516	186	3%
Aeronautics .....	893	724	554	-170	-23%
Exploration Systems <sup>4</sup> .....	1,452	921	856	-65	-7%
Innovative Partnerships .....	215	198	198	.....	.....
<b>Energy<sup>5</sup></b> .....	<b>5,625</b>	<b>6,186</b>	<b>6,906</b>	<b>720</b>	<b>12%</b>
Science Programs .....	3,596	4,102	4,398	296	7%
Electricity Transmission & Distribution .....	136	96	86	-10	-10%
Nuclear Energy .....	416	560	811	251	45%
Energy Efficiency and Renewable Energy Resources <sup>6</sup> .....	896	963	1,047	84	9%
Fossil Energy R&D <sup>7</sup> .....	581	465	564	99	21%
<b>National Science Foundation</b> .....	<b>5,581</b>	<b>6,020</b>	<b>6,429</b>	<b>409</b>	<b>7%</b>
<b>Defense</b> .....	<b>6,405</b>	<b>6,895</b>	<b>5,785</b>	<b>-1,110</b>	<b>-16%</b>
Basic Research .....	1,457	1,565	1,428	-137	-9%
Applied Research .....	4,948	5,330	4,357	-973	-18%
<b>Agriculture</b> .....	<b>2,170</b>	<b>1,921</b>	<b>1,934</b>	<b>13</b>	<b>1%</b>
CSREES Research and Education <sup>8</sup> .....	675	569	566	-3	-1%
Economic Research Service .....	75	83	83	.....	.....
Agricultural Research Service <sup>9</sup> .....	1,141	1,001	1,022	21	2%
Forest Service: Forest and Rangeland Research .....	279	268	263	-5	-2%
<b>Interior (USGS)</b> .....	<b>965</b>	<b>945</b>	<b>975</b>	<b>30</b>	<b>3%</b>
<b>Commerce</b> .....	<b>939</b>	<b>869</b>	<b>944</b>	<b>75</b>	<b>9%</b>
NOAA: Oceanic & Atmospheric Research .....	369	338	358	20	6%
NIST Intramural Research and Facilities .....	570	531	586	55	10%
<b>Veterans Affairs<sup>10</sup></b> .....	<b>769</b>	<b>765</b>	<b>822</b>	<b>57</b>	<b>7%</b>
<b>Environmental Protection Agency<sup>11</sup></b> .....	<b>761</b>	<b>816</b>	<b>781</b>	<b>-35</b>	<b>-4%</b>
<b>Transportation</b> .....	<b>563</b>	<b>598</b>	<b>570</b>	<b>-28</b>	<b>-5%</b>
Highway research: Federal Highway Administration .....	426	468	430	-38	-8%
Federal Aviation Administration: Research, Engineering, and Development .....	137	130	140	10	8%
<b>Education</b> .....	<b>342</b>	<b>342</b>	<b>342</b>	.....	.....
Special Education Research and Innovation .....	72	72	72	.....	.....
National Institute on Disability and Rehabilitation Research .....	107	107	107	.....	.....
Research, Development, and Dissemination <sup>12</sup> .....	163	163	163	.....	.....
<b>Total</b> .....	<b>60,032</b>	<b>60,799</b>	<b>61,312</b>	<b>513</b>	<b>1%</b>

<sup>1</sup> The amounts included as 2007 Estimates in this table reflect the 2007 Budget levels, with the exception of the numbers for the Department of Defense, which are the enacted levels.

<sup>2</sup> In 2006, the Department of Health and Human Services allocated 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.

<sup>3</sup> Due to recent changes in NASA's approach to budgeting overhead costs, 2008 funding levels are not comparable to 2006 and 2007 levels.

<sup>4</sup> Includes Exploration Technology Development, the Human Research Program, and the Lunar Precursor Robotic Program.

<sup>5</sup> 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.

<sup>6</sup> 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.

<sup>7</sup> Excludes funding for the Alaska Natural Gas Pipeline project.

<sup>8</sup> Includes the appropriation of earnings from the Native American Endowment Fund, but not the appropriation to the Endowment's principal.

<sup>9</sup> Excludes building and facilities. Excludes \$6 million transfer to the account in 2006.

<sup>10</sup> Includes the medical care and prosthetic research appropriation and VA medical care support transfer to research.

<sup>11</sup> Science and Technology, plus superfund transfer.

<sup>12</sup> Does not include funding for Regional Educational Labs.

Table 5-3. AGENCY DETAIL OF SELECTED INTERAGENCY R&amp;D EFFORTS

(Budget authority, dollar amounts in millions)

	2006 Actual	2007 Estimate <sup>1</sup>	2008 Proposed	Dollar Change: 2007 to 2008	Percent Change: 2007 to 2008
<b>Networking and Information Technology R&amp;D <sup>2</sup></b>					
Defense .....	1,106	1,046	1,027	-19	-2%
National Science Foundation .....	812	904	994	90	10%
Health and Human Services <sup>3</sup> .....	486	541	463	-78	-14%
Energy .....	282	389	404	15	4%
National Aeronautics and Space Administration .....	78	82	85	3	4%
Commerce .....	64	73	73	.....	N/A
Environmental Protection Agency .....	6	6	6	.....	N/A
National Archives and Records Administration .....	4	4	5	1	25%
<b>Total .....</b>	<b>2,838</b>	<b>3,045</b>	<b>3,057</b>	<b>12</b>	<b>0%</b>
<b>National Nanotechnology Initiative</b>					
National Science Foundation .....	360	373	390	17	5%
Defense .....	424	417	375	-42	-10%
Energy .....	231	293	332	39	13%
Health and Human Services <sup>4</sup> .....	196	175	208	33	19%
Commerce (NIST) .....	78	89	97	8	9%
National Aeronautics and Space Administration .....	50	25	24	-1	-4%
Environmental Protection Agency .....	5	9	10	1	11%
Agriculture .....	6	7	8	1	14%
Transportation .....	1	1	1	.....	N/A
Justice .....	.....	1	1	.....	N/A
Homeland Security .....	2	1	1	.....	N/A
<b>Total .....</b>	<b>1,353</b>	<b>1,391</b>	<b>1,447</b>	<b>56</b>	<b>4%</b>
<b>Climate Change Science Program</b>					
National Aeronautics and Space Administration <sup>5</sup> .....	1,045	981	871	-110	-11%
National Science Foundation .....	197	205	208	3	1%
Commerce (NOAA) .....	157	173	174	1	1%
Energy .....	130	126	130	4	3%
Agriculture .....	61	60	59	-1	-2%
National Institutes of Health .....	50	57	50	-7	-12%
Interior (USGS) .....	27	26	27	1	4%
Environmental Protection Agency .....	19	18	18	.....	N/A
Smithsonian .....	6	6	6	.....	N/A
Transportation .....	1	1	1	.....	N/A
U.S. Agency for International Development <sup>6</sup> .....	13	14	.....	N/A	N/A
<b>Total .....</b>	<b>1,706</b>	<b>1,667</b>	<b>1,544</b>	<b>-123</b>	<b>-7%</b>

<sup>1</sup> The amounts included as 2007 Estimates in these tables reflect the 2007 Budget levels, with the exception of the numbers for the Department of Defense and the Department of Homeland Security, which are the enacted levels.

<sup>2</sup> DHS NITRD funding information is not yet available.

<sup>3</sup> Includes funds from offsetting collections for the Agency for Healthcare Research and Quality.

<sup>4</sup> Includes funds from both the National Institutes of Health and National Institute of Occupational Safety and Health.

<sup>5</sup> Beginning with the 2007 Estimate, NASA is no longer counting its Ground Network and Research Range within its CCSP totals.

<sup>6</sup> USAID CCSP funding information for 2008 is not yet available.

## 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 inter-

national 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 acqui-

sition 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 \$430.4 billion in 2006. They are estimated to increase to \$434.9 billion in 2007 and are projected to decline to \$430.1 billion in 2008. Major Federal investment outlays will comprise an estimated 15 percent of total Federal outlays in 2008 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 \$221.1 billion in 2008. Physical investment outlays are for construction and rehabilitation, the purchase of major equipment, and the purchase or sale of land and structures. Approximately two-thirds 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 \$117.6 billion in 2008. Almost all of these outlays, or an estimated \$107.8 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 \$31.6 billion in 2008. These outlays include \$18.3 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; construction for the administration of justice programs (largely in the Department of Homeland Security), construction of office buildings by the General Services Administration, and construction for embassy security. Outlays for the acquisition of major equipment are estimated to be \$13.4 billion in 2008. The largest amounts are for the air traffic control system; law enforcement activities, largely in the Department of Homeland Security and the Federal Bureau of Investigation; and information systems in the Department of Veterans Affairs.

Grants to State and local governments for physical investment are estimated to be \$71.8 billion in 2008. More than two-thirds of these outlays, or \$51.6 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 \$127.0 billion in 2008. 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 \$72.9 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 \$54.1 billion in 2008. 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 \$82.1 billion in 2008. 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 \$53.6 billion in 2008, 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 \$28.5 billion in 2008. Programs in this category are primarily aid for higher education through student financial assistance, loan subsidies, the

**Table 6-1. COMPOSITION OF FEDERAL INVESTMENT OUTLAYS**

(In billions of dollars)

	2006 Actual	Estimate	
		2007	2008
Major public physical capital investment:			
Direct Federal:			
National defense .....	97.3	113.3	117.6
Nondefense .....	29.0	32.5	31.6
Subtotal, direct major public physical capital investment .....	126.3	145.8	149.2
Grants to State and local governments .....	64.1	69.2	71.8
Subtotal, major public physical capital investment .....	190.4	215.0	221.1
Conduct of research and development:			
National defense .....	73.0	75.5	72.9
Nondefense .....	49.8	52.7	54.1
Subtotal, conduct of research and development .....	122.8	128.1	127.0
Conduct of education and training:			
Grants to State and local governments .....	56.2	57.3	53.6
Direct Federal .....	61.0	34.5	28.5
Subtotal, conduct of education and training .....	117.2	91.8	82.1
<b>Total, major Federal investment outlays .....</b>	<b>430.4</b>	<b>434.9</b>	<b>430.1</b>
<b>MEMORANDUM</b>			
Major Federal investment outlays:			
National defense .....	170.3	188.7	190.6
Nondefense .....	260.1	246.2	239.5
Total, major Federal investment outlays .....	430.4	434.9	430.1
Miscellaneous physical investment:			
Commodity inventories .....	-1.0	-0.2	0.2
Other physical investment (direct) .....	3.1	3.2	3.4
Total, miscellaneous physical investment .....	2.1	3.0	3.6
Total, Federal investment outlays, including miscellaneous physical investment .....	432.5	437.9	433.7

veterans GI bill, and health training programs. The decline in spending from 2006 to 2007 reflects a significant decrease in estimates of Federal subsidies due to reduced student loan consolidation activity.

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 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. Purchases are estimated to exceed sales by \$0.2 billion in 2008.

Outlays for other miscellaneous physical investment are estimated to be \$3.4 billion in 2008. 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		
	2006 Actual	2007 Estimate	2008 Estimate	2006 Actual	2007 Estimate	2008 Estimate
<b>GRANTS TO STATE AND LOCAL GOVERNMENTS</b>						
Major public physical investments:						
Construction and rehabilitation:						
Transportation:						
Highways .....	36,357	37,555	39,943	33,975	34,914	37,621
Mass transportation .....	9,768	8,738	9,273	8,430	10,048	10,276
Air transportation .....	3,070	4,267	2,750	3,841	3,821	3,711
Subtotal, transportation .....	49,195	50,560	51,966	46,246	48,783	51,608
Other construction and rehabilitation:						
Pollution control and abatement .....	1,878	1,961	1,748	1,740	1,685	1,546
Community and regional development .....	22,054	5,173	3,535	6,310	9,147	9,231
Housing assistance .....	6,169	6,127	5,525	7,750	7,566	7,563
Other construction .....	579	311	289	553	533	379
Subtotal, other construction and rehabilitation .....	30,680	13,572	11,097	16,353	18,931	18,719
Subtotal, construction and rehabilitation .....	79,875	64,132	63,063	62,599	67,714	70,327
Other physical assets .....	1,423	1,372	1,299	1,515	1,494	1,507
Subtotal, major public physical capital .....	81,298	65,504	64,362	64,114	69,208	71,834
Conduct of research and development:						
Agriculture .....	266	275	229	270	284	276
Other .....	169	165	164	171	130	130
Subtotal, conduct of research and development .....	435	440	393	441	414	406
Conduct of education and training:						
Elementary, secondary, and vocational education .....	38,295	36,230	36,936	37,984	38,258	35,467
Higher education .....	501	500	337	540	582	510
Research and general education aids .....	764	784	694	727	813	710
Training and employment .....	4,965	5,157	4,803	4,801	4,749	4,543
Social services .....	10,109	10,239	9,567	10,015	10,255	9,873
Agriculture .....	456	456	436	423	443	496
Other .....	1,700	2,216	1,997	1,682	2,189	1,979
Subtotal, conduct of education and training .....	56,790	55,582	54,770	56,172	57,289	53,578
<b>Subtotal, grants for investment</b> .....	<b>138,523</b>	<b>121,526</b>	<b>119,525</b>	<b>120,727</b>	<b>126,911</b>	<b>125,818</b>
<b>DIRECT FEDERAL PROGRAMS</b>						
Major public physical investment:						
Construction and rehabilitation:						
National defense:						
Military construction and family housing .....	9,500	9,407	11,527	6,439	8,870	9,426
Atomic energy defense activities and other .....	668	628	489	654	577	504
Subtotal, national defense .....	10,168	10,035	12,016	7,093	9,447	9,930
Nondefense:						
International affairs .....	1,357	924	1,492	1,585	1,542	1,228
General science, space, and technology .....	2,114	1,941	2,285	2,183	2,879	3,261
Water resources projects .....	4,815	2,823	2,746	3,161	4,289	3,000
Other natural resources and environment .....	1,144	860	884	982	990	956
Energy .....	1,387	1,245	1,275	1,354	1,215	1,352
Postal Service .....	950	1,288	1,214	737	793	1,122
Transportation .....	130	136	64	91	218	123
Veterans hospitals and other health facilities .....	2,867	1,343	2,006	1,946	1,844	1,937
Administration of justice .....	821	1,658	1,518	467	1,397	1,799
GSA real property activities .....	1,911	949	1,420	1,484	1,476	1,839

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

(In millions of dollars)

Description	Budget Authority			Outlays		
	2006 Actual	2007 Estimate	2008 Estimate	2006 Actual	2007 Estimate	2008 Estimate
Other construction .....	1,938	1,776	1,342	1,991	1,966	1,680
Subtotal, nondefense .....	19,434	14,943	16,246	15,981	18,609	18,297
Subtotal, construction and rehabilitation .....	29,602	24,978	28,262	23,074	28,056	28,227
Acquisition of major equipment:						
National defense:						
Department of Defense .....	105,370	126,244	137,220	89,796	103,508	107,398
Atomic energy defense activities .....	510	490	383	444	344	354
Subtotal, national defense .....	105,880	126,734	137,603	90,240	103,852	107,752
Nondefense:						
General science and basic research .....	604	637	926	578	608	890
Space flight, research, and supporting activities .....	360	290	492	291	543	405
Postal Service .....	1,339	1,782	1,442	1,430	1,017	1,294
Air transportation .....	3,310	3,333	860	2,615	2,737	1,817
Water transportation (Coast Guard) .....	1,340	1,264	892	882	1,094	1,115
Other transportation (railroads) .....	1,293	1,114	900	1,257	1,188	900
Hospital and medical care for veterans .....	1,132	236	770	784	633	604
Law enforcement activities .....	1,802	1,902	2,054	1,448	1,891	1,939
Department of the Treasury (fiscal operations) .....	237	251	331	261	214	278
Department of Commerce (NOAA) .....	944	935	890	1,000	875	900
GSA general services funds .....	763	816	833	719	824	865
Other .....	2,038	1,767	2,544	1,473	1,952	2,425
Subtotal, nondefense .....	15,162	14,327	12,934	12,738	13,576	13,432
Subtotal, acquisition of major equipment .....	121,042	141,061	150,537	102,978	117,428	121,184
Purchase or sale of land and structures:						
National defense .....	-65	-39	-37	-65	-39	-37
Natural resources and environment .....	97	115	-323	145	129	-301
General government .....	168	164	156	162	164	156
Other .....	42	160	25	18	25	2
Subtotal, purchase or sale of land and structures .....	242	400	-179	260	279	-180
Subtotal, major public physical investment .....	150,886	166,439	178,620	126,312	145,763	149,231
Conduct of research and development:						
National defense:						
Defense military .....	73,559	77,821	78,243	69,323	71,755	69,856
Atomic energy and other .....	3,917	3,608	3,645	3,720	3,726	3,079
Subtotal, national defense .....	77,476	81,429	81,888	73,043	75,481	72,935
Nondefense:						
International affairs .....	255	255	255	258	258	258
General science, space, and technology:						
NASA .....	8,227	9,131	9,330	6,807	8,438	9,445
National Science Foundation .....	3,806	3,780	4,373	3,707	3,943	3,894
Department of Energy .....	2,914	2,943	3,394	2,966	3,013	3,192
Subtotal, general science, space, and technology .....	15,202	16,109	17,352	13,738	15,652	16,789
Energy .....	1,219	1,364	1,409	1,156	1,241	1,409
Transportation:						
Department of Transportation .....	792	729	788	563	576	499
NASA .....	893	589	730	722	736	669
Other .....	17	17	18	20	13	13
Subtotal, transportation .....	2,921	2,699	2,945	2,461	2,566	2,590
Health:						
National Institutes of Health .....	27,524	27,641	27,956	26,695	26,974	27,580

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

(In millions of dollars)

Description	Budget Authority			Outlays		
	2006 Actual	2007 Estimate	2008 Estimate	2006 Actual	2007 Estimate	2008 Estimate
All other health .....	694	676	671	653	659	670
Subtotal, health .....	28,218	28,317	28,627	27,348	27,633	28,250
Agriculture .....	1,588	1,485	1,397	1,509	1,511	1,458
Natural resources and environment .....	2,106	1,922	1,947	1,513	1,613	1,674
National Institute of Standards and Technology .....	366	319	398	398	378	409
Hospital and medical care for veterans .....	824	818	822	799	809	799
All other research and development .....	1,919	1,547	1,728	1,545	2,084	1,701
Subtotal, nondefense .....	53,144	53,216	55,216	49,311	52,246	53,670
Subtotal, conduct of research and development .....	130,620	134,645	137,104	122,354	127,727	126,605
Conduct of education and training:						
Elementary, secondary, and vocational education .....	1,355	1,326	1,080	1,656	1,634	1,343
Higher education .....	57,017	24,128	20,691	50,716	23,441	17,841
Research and general education aids .....	1,993	1,933	2,173	1,902	2,050	2,057
Training and employment .....	359	359	364	469	549	534
Health .....	1,353	1,351	994	1,334	1,311	1,222
Veterans education, training, and rehabilitation .....	3,338	2,842	3,332	2,980	3,321	3,316
General science and basic research .....	889	886	945	902	909	992
National defense .....				5		
International affairs .....	485	474	515	448	462	499
Other .....	655	555	611	595	826	672
Subtotal, conduct of education and training .....	67,444	33,854	30,705	61,007	34,503	28,476
<b>Subtotal, direct Federal investment .....</b>	<b>348,950</b>	<b>334,938</b>	<b>346,429</b>	<b>309,673</b>	<b>307,993</b>	<b>304,312</b>
<b>Total, Federal investment .....</b>	<b>487,473</b>	<b>456,464</b>	<b>465,954</b>	<b>430,400</b>	<b>434,904</b>	<b>430,130</b>

## 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 fifth year of using the PART, the Administration has assessed nearly 1,000 programs, approximately 96 percent 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 per-

cent 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 244 programs:

- Programs for capital assets are essentially those identified in the PART system as “capital assets and service acquisition” (92 programs);



- Programs for research and development are essentially those identified in the PART system as “research and development” (121 programs); and
- Programs for education and training (31 programs) are primarily programs in the Department of Education (e.g., Federal Pell Grants) that are not grants to State and local governments. This category 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](http://www.ExpectMore.gov).

*Summary of ratings.* Table 6–3 shows that the average rating for the 244 investment programs that have been rated by PART was “Moderately Effective”. Of these programs:

- 57 were rated Effective;
- 83 were rated Moderately Effective;
- 55 were rated Adequate;
- 8 were rated Ineffective; and
- 41 were rated “Results Not Demonstrated”.

**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
	Average scores			
Purpose .....	84%	92%	80%	88%
Planning .....	80%	83%	74%	81%
Management .....	83%	87%	72%	84%
Results/Accountability .....	56%	60%	35%	55%
Weighted Average <sup>1</sup> .....	69%	74%	55%	70%
Average Rating .....	Adequate	Moderately effective	Adequate	Moderately effective
	Number of Programs			
	Ratings <sup>2</sup>			
Effective .....	20	35	2	57
Moderately effective .....	31	49	3	83
Adequate .....	20	21	14	55
Ineffective .....	2	3	3	8
Results not demonstrated .....	19	13	9	41
Total number of investment programs rated .....	92	121	31	244

<sup>1</sup> Weighted as follows: Purpose (20 percent), Planning (10 percent), Management (20 percent), Results/Accountability (50 percent).

<sup>2</sup> The rating of Effective indicates a score of 85 percent or more; Moderately Effective, 70–84 percent; Adequate, 50–69 percent; and Ineffective, 49 percent or less.

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

### Capital Assets

*Department of Defense.* Air Force Acquisition Systems. (\$31.8 billion in 2006). Rating: *Moderately Effective*. This program acquires the equipment and other materiel needed by the Air Force to enable it to fulfill its mission of defeating enemy forces and protecting American troops.

The Air Force acquisition system delivers equipment that generally meets its required performance goals and fulfills the warfighters’ needs. The acquisition system does not include control mechanisms to effectively limit factors which contribute to cost and schedule overruns. While the acquisition system already includes a limited number of specific performance measures, additional measures would help to better determine how well the acquisition system is performing.

*Department of Defense.* Marine Corps/Expeditionary Warfare. (\$14.0 billion in 2006). Rating: *Moderately Effective*. 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 (DoD) has articulated a limited number of long-term performance measures for the expeditionary warfare program in response to an earlier assessment. DoD has identified goals related to Joint and Coalition Proficiency, Operational Reach, Force Projection, Sustainability, and Operational and Organizational Adaptability for the expeditionary warfare capability.

*Department of Defense.* Navy Shipbuilding (\$13.4 billion in 2006). 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 281 ships in the fleet.

The Navy has specific cost, schedule, and performance goals for each shipbuilding program. 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.

*Department of Defense (DoD).* Air Combat Program (\$13.4 billion in 2006). 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 management of the overall air combat program is currently based on the extensive system of regulations governing how individual acquisition programs are managed. Through these regulations DoD tracks the progress of individual programs and can hold managers accountable for their programs. 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.

*Department of Defense.* Future Combat Systems/Modularity Land Warfare (\$9.7 billion in 2006). 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.

*Tennessee Valley Authority.* Tennessee Valley Authority Power (\$9.3 billion in 2006). Rating: *Moderately Effective*. The Tennessee Valley Authority (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. The Tennessee Valley Authority committed to a debt reduction plan that will reduce its total debt \$3 billion - \$5 billion over a ten to twelve year period. TVA has since increased that debt reduction total to \$7.8 billion by 2016.

*Department of Energy.* Environmental Management (\$7.9 billion in 2006). 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. For example, the program is renegotiating cleanup contracts to include performance incentives. The program is also reorganizing operations to focus on risk reduction. The program needs to develop annual cost and schedule performance measures. The Department of Energy Inspector General and the Government Accountability Office have identified better performance measures as critical to assessing program achievements.

*Department of Defense.* Missile Defense (\$7.7 billion in 2006). 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.

## Education

*Department of Education.* Federal Pell Grants (\$17.3 billion in 2006). 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 life-long 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 (\$17.3 billion (subsidy cost) in 2006). 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.

### 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 reduces 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 R&D 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 R&D or education can be carried out by Federal or State government laboratories, universities and other nonprofit organizations, local governments, or private industry. R&D 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

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 the program had meaningful performance measures and outcome data, it also found that it could be more cost efficient.

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 2006, with periods of faster growth during the late 1960s and the 1980s. The stock amounted to \$2,315 billion in 2006 and is estimated to increase to \$2,454 billion by 2008. In 2006, the national defense capital stock accounted for \$700 billion, or 30 percent of the total, and nondefense stocks for \$1,615 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	Transportation	Community and Regional	Natural Resources	Other
<b>Five year intervals:</b>											
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
<b>Annual data:</b>											
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 .....	2,198	662	1,536	391	168	223	1,146	714	196	136	100
2005 .....	2,256	680	1,576	400	168	232	1,176	736	198	137	105
2006 .....	2,315	700	1,615	410	169	240	1,205	758	200	138	109
2007 estimate .....	2,387	729	1,658	421	171	250	1,236	781	203	139	114
2008 estimate .....	2,454	756	1,697	431	172	259	1,267	804	207	139	117

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 \$1,615 billion in 2006. With the investments proposed in the budget, nondefense stocks are estimated to grow to \$1,697 billion in 2008. 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 \$756 billion in 2008.

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 2006, 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 (R&D) 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 \$1,142 billion in 2006 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 2006. 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 \$468 billion in 2008.

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 <sup>1</sup>**

(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	255	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	542	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 .....	431	54	376	639	449	190	1,070	504	566
2005 .....	442	56	386	665	471	194	1,107	527	580
2006 .....	452	57	395	690	493	197	1,142	549	593
2007 estimate .....	462	58	404	716	513	203	1,178	572	606
2008 estimate .....	468	59	409	742	535	207	1,210	594	616

<sup>1</sup> 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 \$1,451 billion in 2006 in constant 2000 dollars. The vast majority of the Nation's education stock is financed by State and local govern-

ments, 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.<sup>1</sup> Nearly three-quarters is for elementary and secondary education, while the remainder is for higher education.

<sup>1</sup> For estimates of the total education stock, see table 13-5 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 2006.

The expansion of the education stock is projected to continue under this budget, with the stock rising to \$1,557 billion in 2008.

**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 .....	234	184	50
1975 .....	349	282	67
1980 .....	482	379	103
1985 .....	577	434	143
1990 .....	736	549	188
1995 .....	880	643	237
Annual data:			
2000 .....	1,133	825	308
2001 .....	1,184	859	325
2002 .....	1,227	890	336
2003 .....	1,267	924	343
2004 .....	1,328	961	367
2005 .....	1,383	1,013	370
2006 .....	1,451	1,057	394
2007 estimate .....	1,505	1,099	406
2008 estimate .....	1,557	1,141	415

## 7. CREDIT AND INSURANCE

Federal credit and insurance programs are alternatives to direct spending programs as means of achieving a variety of policy objectives. Federal credit programs offer direct loans and loan guarantees to support a wide range of activities including housing, education, business and community development, and exports. At the end of 2006, there were \$251 billion in Federal direct loans outstanding and \$1,120 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 permits certain privately owned companies, called Government-Sponsored Enterprises (GSEs), to operate under Federal charters for the purpose of enhancing credit availability for targeted sectors. GSEs increase liquidity by guaranteeing and securitizing loans, as well as by providing direct loans. In return for advancing certain social goals and possibly improving economic efficiency, GSEs enjoy various special privileges, such as possible borrowing from Treasury at Treasury's discretion, exemption from State and local income taxation, and favorable regulatory treatments of their securities. These privileges may leave observers with the impression that GSE 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 emphasizes the roles of Federal credit and insurance programs in addressing market imperfections that may prevent the private market from efficiently providing credit and insurance. Federal programs are more useful where market imperfections remain serious even though the continued evolution and deepening of financial markets may have in part corrected many of the imperfections.
- The second section interprets the results of the Program Assessment Rating Tool (PART) for credit and insurance programs in relation to their distinguishing features.
- The third section discusses individual credit programs and GSEs intended to support 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 their 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 do not effectively address market imperfections can be unnecessary, 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; to help 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. Although these imperfec-

tions can cause inefficiencies, the presence of a market imperfection does not mean that Government intervention will be always effective. To be effective, a credit or insurance program should be carefully designed to reduce inefficiencies in the targeted area without causing inefficiencies elsewhere.

**Insufficient Information.** Financial intermediaries may fail to allocate credit to the most deserving borrowers if there is little objective information about some of the borrowers. Some groups of borrowers, such as start-up businesses and some families, 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. Education, for example, generates positive externalities because the general public benefits from the high productivity and good citizenship of a well-educated person. Pollution, from which other people suffer, is clearly a negative externality. 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 through 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 efficiency-improving consolidation by removing geographic and industry barriers.

These changes have reduced market imperfections. 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 need for the Federal government to address the information problem has diminished steadily over the years. 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 risk more objectively and accurately. Also, potential borrowers tend to have access to a much wider array of possible local, national, and global lenders. As a result, most borrowers can easily obtain credit at a fair interest rate reflecting their risk. 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. It is also possible that banking consolidation adversely affects those borrowers with unique characteristics; small, local banks could serve those borrowers better if they had more borrower-specific information gained through long-term relations. 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 with confidence the probability of a major natural disaster occurring. The difficulty may be greater for man-made disasters that lack scientific bases.

Financial evolution has also improved private insurers' ability to deal with catastrophic losses. Using financial derivatives such as options, swaps, and futures, private entities can 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. However, the market for catastrophe-related derivatives is still small, and it has not eliminated the difficulty of absorbing catastrophic losses yet. To address this difficulty, reinsurance may be preferred to direct provision of insurance because it involves less intervention.

Imperfect competition is much less likely to justify Federal involvement than was the case only a few years ago due 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 further lowered the cost of financial transactions and reduced the importance of physical location. These developments have been especially beneficial to small and geographically isolated customers who could not afford to bear large transactions costs and otherwise had limited access to



financial services. In addition, there are more financing alternatives for both commercial and individual borrowers that used to rely heavily on banks. Venture capital, for example, has become a much more important financing source for small businesses. Finance companies have also become a prominent player both in business and consumer financing.

Problems related to externalities may persist because the price mechanisms that drive the private market by definition 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 any 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 economy and 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 the Federal Home Loan Banks, could shake the entire financial market. A more visible risk to the Budget today is posed by the Pension Benefit Guaranty Corporation (PBGC). PBGC has a large shortfall in assets and projected earnings relative to the claims it is already obligated to pay due to unfavorable developments in recent years and to flaws in program structure that the Administration proposes to remedy.

## II. PERFORMANCE OF CREDIT AND INSURANCE PROGRAMS

The Program Assessment Rating Tool (PART) has evaluated 977 Federal programs, including 34 credit programs and seven insurance programs. 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.

The ratings for credit and insurance programs are clustered around the middle; 78 percent of credit and insurance programs (compared with 58 percent for other programs) are rated “adequate” or “moderately effective,” while only seven percent (17 percent for other programs) are rated “effective.” These results suggest that most credit and insurance programs meet basic standards, but need to improve. In individual categories, credit and insurance programs have scored noticeably low in program purpose and design and high in program results relative to other programs.

Some key features 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. Interpreting PART results in relation to these features should help to identify fundamental problems and to devise effective solutions.

**Program Purpose and Design.** To be effective, credit and insurance programs should serve those who deserve to be served but are left out by the private market due to market imperfections. Extending credit to those who are not creditworthy, for example, would result in economic inefficiencies and large budget costs. Lending to those who can obtain credit at a reasonable rate in the private market would be unnecessary and might interfere with the market mechanism. To achieve intended outcomes without causing unintended consequences, therefore, credit and insurance programs need to be carefully designed; they should target the

### SUMMARY OF PART SCORES

	Purpose and Design	Strategic Planning	Program Management	Program Results
Credit and Insurance Programs				
Average .....	78.5	74.2	86.0	55.7
Standard Deviation .....	19.9	24.0	18.4	19.0
All Others Excluding Credit and Insurance Programs				
Average .....	87.1	75.0	82.2	48.2
Standard Deviation .....	18.4	24.6	17.9	26.6

intended beneficiaries, and all parties in the transaction should face the correct incentives.

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 offer inadequate incentive structures.

**Strategic Planning.** Financial markets have been evolving to serve target populations of Federal programs better and increasingly apply advanced technologies to risk assessments. Credit and insurance programs need to adapt to these new developments quickly. Falling behind, Federal programs can be left with many beneficiaries who do not really need Government help and with those who post greater risk as private entities attract better-risk beneficiaries away from Federal programs.

In subcategories of strategic planning, while most credit and insurance programs effectively execute short-term strategies, they are less effective in pursuing long-term goals that may be more critical in adapting to new developments. Other weaknesses are found in conducting stringent performance evaluation and tying budgets to performance outcomes.

**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 the program cost stays within a reasonable range.

Credit and insurance programs show strengths in basic financial and accounting practices, such as spending funds for intended purposes and controlling routine

costs. However, some weaknesses are found in areas that are more critical for effective risk management, such as collecting timely information and using sophisticated financial tools.

**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 estimate 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.

Program results, the most important category of performance, are generally weak for credit and insurance programs despite a higher average score than that of other programs. Many credit and insurance programs have difficulty in achieving performance goals and lack objective evidences of program effectiveness. These problems may partly result from the difficulty of measuring net outcomes. With reliable outcome measures, it should be easier to set achievable goals and demonstrate effectiveness.

### III. CREDIT IN FOUR SECTORS

#### Housing Credit Programs and GSEs

Through housing credit programs, the Federal Government promotes homeownership among various target groups, including low-income people, minorities, veterans, and rural residents. Housing GSEs increase liquidity in the mortgage market.

#### Federal Housing Administration

In June 2002, the President issued America's Homeownership Challenge to increase the number of first-time minority homeowners by 5.5 million through 2010. During the first three and a quarter years since the goal was announced, nearly 2.5 million minority families have become homeowners. Through 2006, the Department of Housing and Urban Development's (HUD's) Federal Housing Administration (FHA) helped almost 542,000 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 2006, FHA endorsed purchase and refinance mortgages for more than 425,000 households. For purchase mortgages, over 79 percent were for first-time homebuyers and about 31 percent were for minority buyers. FHA also endorsed over 76,000 home equity conversion mortgages for elderly homeowners.

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 four 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 that the private sector considered too risky. 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 borrowers, FHA's business has changed. First, the percentage of FHA-insured mortgages with initial loan-to-value (LTV) ratios of 95 percent or higher has increased substantially, from 62.7 percent in 1995 to 78 percent in 2006. Second, the percentage of FHA loans with downpayment assistance from seller-financed nonprofit organizations has grown rapidly, from 0.3 percent in 1998 to nearly 33 percent in 2006. Recent studies show that these loans are riskier than those made to borrowers who received downpayment assistance from other sources. In 2006, FHA's cumulative default claim rate for its core business is projected to have risen from approximately 10 percent to 12 percent.

The FHA single-family mortgage program was assessed in 2005 using the PART. 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 and subsequent reports by the General Accountability Office and the Inspector General 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, FHA measured its 2006 performance against new goals, such as the percentage of FHA Single Family loans for first-time and minority homeowners, and exceeded its goals. FHA has also improved the accuracy of its annual actuarial review claim and prepayment estimates. In 2007, it will continue to develop performance goals for fraud detection and prevention.

### **Proposals for Program Reform**

In order to enable FHA to fulfill its mission in today's changing marketplace, the Administration has introduced 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, additional reforms will enable it to expand homeownership opportunities to its target borrowers on an actuarially sound basis.

To remove two large barriers to homeownership—having limited savings for a downpayment or impaired credit—the Administration again proposes new FHA mortgage products. These products will replace the current flat premium structure with one that varies with the risk of default as indicated by the percentage of downpayment to the loan amount or borrower credit quality. This will create more opportunities for potential homeowners who may face limited mortgage options. For example, first-time buyers with a strong credit record but little savings could finance a higher percent of the purchase than FHA currently allows. Alternatively, a borrower with a poor credit history could qualify for more favorable terms by accumulating savings for a larger downpayment.

This flexible premium structure, which is tiered risk-based pricing, is a way to more fairly price the FHA guarantee to individual borrowers. It creates incentives (lower premium payments) for borrowers to take steps to improve their credit or save more for a downpayment. At the same time it eliminates the current incentive for higher risk borrowers to use FHA because they are undercharged relative to the risk they pose. FHA proposes to base its mortgage insurance premiums upon a borrower's consumer credit score from Fair, Isaac, and Company (FICO), and on the amount and source of downpayment (e.g., 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, FHA will reflect a borrower's risk via the mortgage insurance premium, not through a higher interest rate as done in the subprime market. With mortgage insurance, borrowers will pay a market rate of interest, and, as a result, will incur lower monthly payments and lower total costs than if they paid a higher mortgage interest rate throughout the life of the loan. Second, by using this pricing structure, FHA will promote price transparency. Each borrower will know why they are paying the premium that they are being charged and will know how to lower their borrowing costs—i.e., by raising their FICO score or their downpayment. Third, risk-based pricing will allow FHA to review the performance of its programs annually in conjunction with the preparation of its credit subsidy estimates and 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. Further, the proposed reforms will better enable FHA to 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 2006, VA provided \$23.5 billion in guarantees to assist 135,151 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 downpayment loans. VA provided 90,399 zero downpayment loans in 2006.

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 54 percent of such delinquent loans avoiding foreclosure in 2006.

## 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. In 2006, nearly \$4.3 billion in assistance was provided by RHS for homeownership loans and loan guarantees; \$3.07 billion in guarantees went to more than 31,000 households, of which 30 percent went to very low and low-income families (with income 80 percent or less than median area income).

Additionally in 2006, Hurricane Supplemental loans and guarantees totaling \$260 million allowed nearly 2,500 households to obtain homes. In addition, \$19 million of low-interest loans and grants was used to repair more than 2,300 homes of families in need. In addition, RHS granted moratoriums on payments, and sheltered survivors in its inventory properties to provide relief.

Historically, RHS has offered both direct and guaranteed homeownership loans. Beginning in 2008, RHS will only offer guaranteed loans. The budget provides no funding for the 502 direct single family housing loan program. The direction of Rural Development's single-family housing mortgage assistance over the last two decades has been towards guaranteed loans. The single-family housing guaranteed loan program was newly authorized in 1990 at \$100 million and has grown into a \$3 billion plus loan program annually, equaling that of the Veterans Affairs (VA) guaranteed housing loan program. Meanwhile the single-family direct loan program has been stagnant at approximately a \$1 billion loan level.

Solely utilizing guarantees for single-family housing mortgage is consistent with the other Federal homeownership programs. In fact, there are no Federal single family direct loan home ownership programs for

urban areas. Furthermore, financial markets have become more efficient and increased the reach of mortgage credit to lower credit qualities and incomes. While some rural areas remain isolated from broad credit availability, these areas are shrinking as broadband internet access and correspondent lending grow. Therefore, relying on the private banking industry to provide this service, with a guarantee from the Federal government, is a more efficient way to deliver that assistance.

To replace the loss of assistance to the very low- to low-income rural borrowers still seeking assistance for mortgage credit, the Administration expects to propose legislation to authorize a subsidized guaranteed single-family housing program.

For the already established 502 guarantee programs in 2008, RHS will increase the guarantee fee on new 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. The guarantee fee for refinance loans remains 0.5 percent. Funding in 2008 is requested at an increased amount of \$4.8 billion for purchase loans to compensate for no funding for direct loans.

RHS also offers multifamily housing loans and guarantees to provide rural rental housing, including farm labor housing. The farm labor housing combined grant and loan level will provide \$18 million in 2008 for new construction as well as repair and rehabilitation. RHS also expects to be able to guarantee \$200 million in multifamily housing construction loans for 2008. 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 2008, \$28 million will be directed to the revitalization initiative, primarily to assist 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.

RHS partnered with its multifamily program borrowers and made available all the vacant units in the loan portfolio to house evacuees from Hurricanes Katrina and Rita. Costs were covered by an emergency allotment of rental assistance for a six-month period. Multifamily Programs instituted a number of waivers designed to ease the regulatory burden for housing evacuees on an emergency basis. RHS housed over 3,000 families in RHS-financed housing

## Government-Sponsored Enterprises in the Housing Market

Homeownership has long been recognized as an important part of the American economy and part of the American dream. However, it has not always been within reach for the average American. During the Great Depression, housing markets were in turmoil. A typical mortgage required a downpayment of around 50 percent and a balloon payment of principal within a few years. Limitations in financial and communication technology

and restrictions on financial institutions made it difficult for surplus funds in one part of the country to be shifted to other parts of the country to finance residential housing. Starting in 1932, the Congress responded by creating a series of entities and programs that together promoted the development of long-term, amortizing mortgages and facilitated the movement of capital to support housing finance.

A key element of this response was the creation of the Federal Housing Administration in 1934. Another element was the establishment of several entities designed to develop secondary mortgage markets and to facilitate the movement of capital into housing finance. These entities, known today as Government-Sponsored Enterprises (GSEs), were chartered by the Congress with a public mission, and endowed with certain benefits that give them competitive advantages when compared with fully private companies.

The Federal Home Loan Bank System, created in 1932, is comprised of twelve individual banks with shared liabilities. Together they lend money to financial institutions—mainly banks and thrifts—that are involved in mortgage financing to varying degrees, and they also finance some mortgages on their own balance sheets. The Federal National Mortgage Association, or Fannie Mae, created in 1938, and the Federal Home Loan Mortgage Corporation, or Freddie Mac, created in 1970, were established to support the stability and liquidity of a secondary market for residential mortgage loans. Together these three GSEs currently are involved, in one form or another, with nearly one half of the \$10-plus trillion residential mortgages outstanding in the U.S. today. Their market share peaked at 54 percent in 2003, after which management and internal control problems started to surface.

As with other financial institutions, the Congress also established regulatory regimes to ensure the safety and soundness of the housing GSEs. The Office of Federal Housing Enterprise Oversight (OFHEO), established in 1992 as an independent agency within the Department of Housing and Urban Development, oversees Fannie Mae and Freddie Mac. The Federal Housing Finance Board (FHFB), established in 1989, oversees the Federal Home Loan Bank system. Numerous reports and studies have pointed to various shortcomings with the current regulatory structure for the housing GSEs. The Administration is proposing to strengthen this structure and combine OFHEO and FHFB into a new regulator.

### **Mission**

The mission of the housing GSEs is to support certain aspects of the U.S. mortgage market. Fannie Mae and Freddie Mac's mission is to promote affordable housing, respond to private capital markets, and provide liquidity and stability to the secondary mortgage market. Currently, they engage in two major lines of business.

1. **Credit Guarantee Business**—Fannie Mae and Freddie Mac guarantee the timely payment of principal and interest on mortgage-backed securities (MBS). They create MBS by either buying

and pooling whole mortgages or by entering into swap arrangements with mortgage originators. Over time these MBS held by the public have averaged about one-quarter of the U.S. mortgage market.

2. **Mortgage Investment Business**—Fannie Mae and Freddie Mac manage retained mortgage portfolios composed of their own MBS, MBS issued by others, and whole mortgages. As of June 30, 2006, these retained mortgages totaled \$1.4 trillion. Given Fannie Mae and Freddie Mac's serious accounting, internal control, risk management, and systems problems, the growth of these portfolios is temporarily constrained through consent agreements with OFHEO.

The mission of the Federal Home Loan Bank System is broadly defined as housing finance, and the System also has specific requirements to support affordable housing. The Federal Home Loan Banks have not grown mortgage asset portfolios as large as Fannie Mae or Freddie Mac. Their principal business remains lending to regulated depository institutions and insurance companies engaged in residential mortgage finance to varying degrees.

### **Risks That GSEs Face and Cause**

Like other financial institutions, the GSEs face a full range of risks, including market (interest rate) risk, credit risk, and operational risk. Several of the Federal Home Loan Banks and Fannie Mae have faced serious market risks due to inadequate hedging. More recently, Fannie Mae and Freddie Mac have faced serious operational risk. Due to earnings manipulation, poor accounting systems, lack of proper controls, lack of proper risk management, and misapplication of accounting principles, earnings at Fannie Mae were misstated by \$6.3 billion through June of 2004, and at Freddie Mac by \$5.0 billion through December of 2002.

The GSEs also pose risks to the financial system. Systemic risk is the risk that unanticipated problems at a financial institution or group of institutions could lead to problems more widely in the financial system or 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 and mortgage finance markets but other vital parts of the financial system and economy. To understand this risk, one must understand the interdependencies among the GSEs and other market participants in the financial system and the lack of market discipline imposed on the GSEs because investors perceive that the GSEs are implicitly backed by the U.S. Government.

The GSEs are among the largest borrowers in the world. As of September 2006 their combined debt and guaranteed MBS totaled \$5.2 trillion, higher than the total publicly held debt of the United States. The inves-

tors in GSE debt include thousands of banks, 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 the Federal Government guarantees GSE debt. In fact, there is no such guarantee or Federal backing of GSE debt.

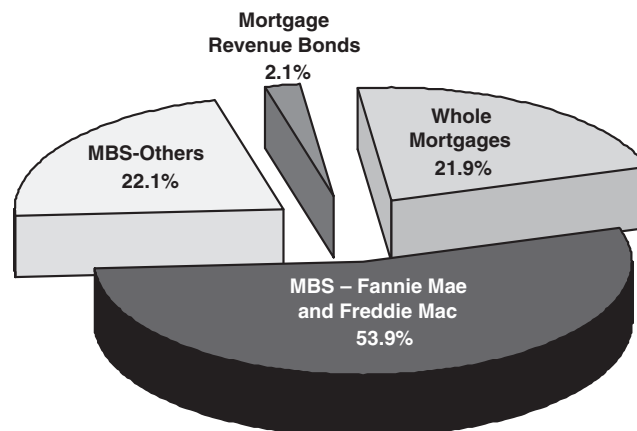
Because investors act as if there is an “implicit guarantee” by the Federal Government to back GSE debt, investors on average lend their money to the GSEs at interest rates roughly 30 to 40 basis points less (\$300–\$400 less per year for every \$100,000 borrowed) than to other highly rated privately held companies. In addition, investors do not demand the same financial disclosures as for other privately owned companies. Neither Fannie Mae nor Freddie Mac currently file quarterly earnings reports with the Securities and Exchange Commission, though Fannie Mae is required to and Freddie Mac volunteered to. 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.

### Retained Asset Portfolios Have Significantly Grown While Achieving Little for the GSEs’ Housing Mission

Fannie Mae and Freddie Mac have used their funding advantage to amass large retained asset portfolios. Together these GSEs have more than \$1.5 trillion in debt outstanding, almost entirely for the purpose of funding these portfolios. From 1990 through 2005, the GSEs’ competitive funding advantage enabled them to increase their portfolios of mortgage assets ten-fold, which far exceeds the growth of the overall mortgage market. Due to the risks associated with the portfolios, the Administration is proposing that the new regulatory structure empower the regulator to address and mitigate these risks.

As chart 7–1 shows, almost 54 percent of Fannie Mae and Freddie Mac’s combined retained mortgage portfolio at the end of 2005 was comprised of holdings of their own guaranteed MBS, which could easily be sold.

**Chart 7-1. Fannie Mae and Freddie Mac Combined Retained Mortgage Portfolios Year-End 2005**



Source: Office of Federal Housing Enterprise Oversight.

The function of these portfolio holdings is largely to increase profits, not facilitate affordable housing. In 1992, the Congress broadened Fannie Mae and Freddie Mac’s mission to include promoting affordable housing. To measure this performance, the Congress mandated that HUD establish three affordable housing goal targets that Fannie Mae and Freddie Mac must meet each year. HUD has also implemented home purchase subgoals to encourage homeownership opportunities for first-time homeowners and minority homeowners. Given

that Fannie Mae and Freddie Mac have a mission to help more families achieve homeownership as well as to expand rental opportunities, their retained portfolios should be tied to that mission. However, currently only about 30 percent of Fannie Mae and Freddie Mac’s retained portfolio holdings would be eligible to qualify for any of the affordable housing goals. About half of the MBS issued by others and whole loans qualify toward their affordable housing goals. Their performance under the housing goals over time indicate that Fannie

Mae and Freddie Mac should be doing more to help mission-targeted families achieve homeownership or acquire affordable rental housing.

### **Debt Issuance Subject to Treasury Approval**

Fannie Mae and Freddie Mac fund their portfolios by issuing debt, and the U.S. Department of the Treasury has the responsibility to review and approve these GSEs' debt-issuances. The Treasury Department's debt approval authority is contained in Fannie Mae's and Freddie Mac's Charter Acts, and the Department has approved Fannie Mae and Freddie Mac's debt on a regular basis. Treasury is developing a more formalized approach to their debt approval authority. As part of that approach, Treasury is developing new debt approval procedures to enhance the clarity, transparency, standardization, and documentation of Fannie Mae's and Freddie Mac's debt issuances.

### **Thin Capital Cushions Need Reform**

The risks of the GSEs' large portfolios are exacerbated because they are not required to hold cushions of capital against potential losses comparable to the capital requirements for other large financial institutions. Where commercial banks that are part of a financial holding company must hold a 5 percent capital-to-total assets cushion, Fannie Mae and Freddie Mac's requirement is half that, while FHLB's is 4 percent. The risk-based capital requirements for the GSEs also differ dramatically from those applicable to commercial banks. This highlights an important shortcoming of the statutory framework governing Federal oversight of the GSEs. The minimum capital and risk-based capital rules for the GSEs were written into law in 1992. Much has changed since then with regard to financial risk analysis, risk modeling, and capital requirements for comparable financial institutions. The reforms proposed by the Administration would repeal the statutory risk-based capital stress test, and would provide the new GSE regulator with the authority and flexibility to establish new risk-based capital requirements for the GSEs to help ensure that they operate with sufficient capital and reserves to support the risks that arise in the operations and management of each enterprise. A world-class regulator needs the flexibility and authority to change both the risk-based and minimum capital requirements without undue restriction in response to changing conditions.

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 risk that homeowners may prepay their mortgages through refinancing or home sales. 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 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.

### **New Activities and Technological Development Require Oversight**

Over the last decade, Fannie Mae and Freddie Mac have begun engaging in a wide range of new activities that were not anticipated when their charters were written. To address these changes, HUD developed a new activity review initiative under its general regulatory authority. HUD has reviewed a number of business initiatives at Fannie Mae and Freddie Mac, including international activities; partnership offices; senior housing; skilled nursing facilities; employer assisted housing plans; third party real-estate-owned programs; Commercial Mortgage-Backed Securities (CMBS); Asset-Backed Securities (ABS); multifamily variable-rate bond certificates; and whole loan REMICs. HUD concluded that some of these activities were not authorized. For example, HUD's review of the GSEs' Commercial MBS programs resulted in OFHEO seeking Freddie Mac's divestiture of certain CMBS holdings, and HUD ordered Fannie Mae to end its third party Real-Estate-Owned program based on its review. In 2007, HUD will complete a Financial Activities Review that will provide a baseline of information on Fannie Mae's and Freddie Mac's business and program activities. As part of this review, HUD will examine specific transactions to determine whether they are consistent with Fannie Mae's and Freddie Mac's charter authorities. The Administration proposes to move this authority to the new regulator.

Because of their enormous presence in the secondary market, Fannie Mae and Freddie Mac are able to exert significant leverage in the *primary* mortgage market. First, their unparalleled size in the residential mortgage market gives the GSEs a unique level of access to market information. The applicability of that information to the management of mortgage risk gives them a competitive edge in the development of new technology that can change relationships between primary market participants as well as the distribution of economic returns between the primary and secondary markets. Second, their funding advantage enables the GSEs to borrow at reduced rates in order to make investments in new areas at below-market prices, thus discouraging competition while gaining experience in those areas.

Through the development and delivery of new technology to the industry and by leveraging their funding advantage, there is potential for the GSEs to expand their business beyond the limitations of their Charter Acts, which prohibits both Fannie Mae and Freddie Mac from originating mortgages. Loan origination is the central function of the primary mortgage market, and the GSEs' charter acts clearly restrict them to the secondary mortgage market. However, technological advancements have blurred the line that defines where

the primary market ends and the secondary market begins. A new level of clarity is required to establish the permissible activities under the Enterprises' charter acts, including the development of intellectual property.

### **New Regulatory Authority**

The Administration continues to support broad reform of the GSE supervisory system. In particular, the Administration supports establishing a new regulator for all three of the housing GSEs that would combine safety and soundness authority with oversight of their respective housing missions. The new regulator must have enhanced powers comparable to those of other world-class financial regulators, including, among others, the ability to put a GSE into receivership should it fail, authority to establish and adjust appropriate capital standards, and new product authority. A new regulator must also have clear authority to address and mitigate the risks posed by the GSEs' retained portfolios. Finally, a new regulatory structure must ensure that the GSEs are adhering to their affordable housing mission.

### **Education Credit Programs**

The Federal Government guarantees loans through intermediary agencies and makes direct loans to students to encourage postsecondary education enrollment. 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 3,600 lenders, 35 State and private guaranty agencies, and over 5,000 participating schools. In the FFEL program, 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 three 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 Gov-

ernment provides loan capital directly to nearly 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.

In 2006, the Congress passed reconciliation legislation reducing excess subsidies in the FFEL program and helping to make both programs more effective. The reforms included 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. In recognition of the fact that federal subsidies remain higher than necessary to ensure that loans are available to students in this profitable and competitive market, the 2008 Budget proposes to reduce interest subsidies paid to FFEL lenders by 50 basis points. The 2008 Budget also proposes to reduce default insurance from 97 percent to 95 percent, and increase the origination fee lenders pay on consolidation loans. To rationalize federal subsidies to guaranty agencies, the Administration proposes to shift the basis of account maintenance fee payments from the balance of loans guaranteed to a cost-per-unit formula, and reduce the amount guaranty agencies can retain on the defaulted loans they collect. These savings will be used to provide significant benefits to students such as raising the Pell Grant maximum award to \$5,400, increasing Academic Competitiveness Grant awards by 50 percent, and offering higher loan limits.

### **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 helps home and business-owners, as well as renters, cover the uninsured costs of recovery from disasters through its direct loan program.

The 2008 Budget requests \$464 million, including administrative funds, for SBA to leverage more than \$29 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 2006, the outstanding balance of business loans totaled \$67 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 about \$230,000 in 2001 to \$152,000 in 2006, while the annual number of new loans has grown from 43,000 to over 90,000 during the same time period.

During the past few years, SBA has implemented several initiatives to streamline operations by increasingly delegating responsibilities to lenders and centralizing operations while managing and mitigating risk. In 2003, SBA implemented a state-of-the-art Lender Loan Monitoring System (LLMS) under the newly formed Office of Lender Oversight. This office uses LLMS to evaluate individual SBA lenders by tracking the expected risk of SBA guaranteed loans in their portfolios relative to expected performance of those loans. The 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 lender risk reviews, credit scoring to compare lenders' performance, and industry concentration analysis. Starting in FY 2004, SBA began consolidating its loan making, servicing and liquidating functions from 69 District Offices into several combined centers. Consolidation has reduced costs, increased timeliness of processing, and standardized how loans are handled. In 2006, SBA completed the elimination of its several billion dollar backlog of loan liquidations resulting from defaulted guarantees. In 2007, SBA is working with contractor support to identify additional processes that could be reengineered to reduce costs, improve quality, and expedite processing.

To address major challenges in making and disbursing loans resulting from the 2005 Gulf Coast hurricanes, SBA initiated the Accelerated Disaster Response Initiative to identify and implement process improvements to quicken the delivery of disaster assistance. As a result of customer feedback and analysis of best business practices, SBA piloted a case management approach. Using case management, in which a team of SBA staff work with a borrower from initial application through loan disbursement, SBA can better serve disaster applicants and monitor the processing of loans. SBA has also implemented numerous productivity metrics to track the status of loans in processing and

identify areas that require management intervention or additional resources.

By 2008, SBA expects to implement an Internet-based loan application system that will facilitate the collection of data from disaster victims and speed processing. This investment complements investments that SBA made through 2006 in the Disaster Credit Management System.

The Budget proposes to build upon the success of the zero-subsidy 7(a) program by making the Microloan program self-financing through modest increases to the interest rate paid by program intermediaries. The Administration is also proposing authorizing legislation to enable the secondary market guarantee (SMG) program to charge nominal fees on lenders seeking to pool loans; fees are expected to be less than or comparable to fees in other secondary market programs and will help stabilize the program from the need to make frequent administrative changes.

### **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 this Budget is \$1.5 billion. These funds are available to communities of 10,000 or fewer residents. The 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 five percent. This change is expected to reduce the loan repayment costs substantially 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 \$512 million in 2008.

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 2008, USDA proposes to provide \$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 one 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 38,795 jobs in 2008 through its 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 \$4.1 billion in direct electric loans for distribution, transmission, and modification of existing generation facilities, \$690 million in direct telecommunications loans, \$300 million in broadband loans, and \$25 million in DLT grants.

Since 1992, RUS electric loans have been used primarily to finance transmission, distribution, and upgrades to generation facilities. During this time, generation has been deregulated and has become a more commercial operation. With the increased needs for all aspects of electricity provision and to ensure adequate funding for rural areas, RUS loans will continue to focus on transmission, distribution, and upgrading generation facilities. Construction of new generation facilities should be financed through the commercial market.

The Rural Telephone Bank successfully dissolved in FY2006. All stock was redeemed during 2006. Loans approved in prior years, but not disbursed are still available for borrowers.

## 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 2.9 percent in 2006, compared to 3.1 percent in 2005. FSA-guaranteed farm loans are made to more credit-worthy 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 0.4 percent in 2006, as compared to 0.45 percent in 2005. 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 2006, FSA provided loans and loan guarantees to approximately 27,730 family farmers totaling \$3.15 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 increas-

ing. 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. In 2008, FSA proposes to make \$3.4 billion in direct and guaranteed loans through discretionary programs.

FSA uses the Farm Business Plan (FBP) to perform financial planning, analysis, and management of the loan portfolio. Several enhancements of the web equity FBP were put into service in 2006. These include a youth loan credit action and availability of additional reports. In 2007, the FBP will be modified to enable credit reports to be ordered on applicants to expedite application processing. FSA is continuing its comprehensive project to streamline all farm loan program regulations, handbooks, and information collections. This is a major effort to streamline the program and reduce the burden for both applicants and the Agency, resulting in an improvement in loan processing efficiencies.

## 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 remain sound. The ratio of capital to assets decreased to 15.7 percent as of September 30, 2006 from 16.8 percent for the same period ended in 2005 as asset growth outpaced capital growth. As of September 30, 2006, capital consisted of \$2.2 billion in restricted capital held by the Farm Credit System Insurance Corporation (FCSIC) and \$22.0 billion of unrestricted capital—a record level. Nonperforming loans decreased, and earnings increased, although rising short-term interest rates and competitive conditions compressed interest margins. The examinations by the Farm Credit Administration (FCA), the System's Federal regulator, also show the strong financial condition of FCS institutions. As of September 2006, all FCS institutions had one of the top two examination ratings (1 or 2 in a 1–5 scale). Assets grew at a brisk pace (9.5 percent annual rate) over the past four years, while the number of FCS institutions decreased due to consolidation. In September 2002, there were seven banks and 104 associations; by September 2006, 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. As of September 30, 2006, the assets in the

Insurance Fund totaled \$2.243 billion. Of that amount \$40 million was allocated to the Allocated Insurance Reserve Accounts (AIRAs). As of September 30, 2006, the Insurance Fund as a percentage of adjusted insured debt was 1.78 percent in the unallocated Insurance Fund and 1.81 percent including the AIRAs. This was below the Secure Base target of 2 percent. During 2006, growth in System debt outpaced the capitalization of the Insurance Fund that occurs through investment earnings and the accrual of premiums.

Over the 12 month period, ending September 30, 2006, the System's loans outstanding grew by \$12.6 billion, or 12.3 percent, while over the past three years they grew by \$24.6 billion, or 26.9 percent. As required by law, borrowers are also stockholder owners of System banks and associations. As of September 30, 2006, the System had 459,635 stockholders. Loans to young, beginning, and small farmers and ranchers represented 12.3, 19.4, and 29.2 percent, respectively, of the total dollar volume of farm loans outstanding at the end of 2005. The percentage of loans to beginning farmers increased in 2005, while percentages 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 legislative 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 its portfolio concentration on agriculture and rural America. While this sector is currently healthy, it is subject to risk due to rapidly rising farm real estate prices, volatile commodity prices and input costs, uncertainty regarding changes in government farm policy and trade agreements, weather-related catastrophes, animal and plant diseases, and off-farm employment opportunities.

### **Farmer Mac**

Farmer Mac was established in 1988 to facilitate a secondary market for farm real estate and rural housing loans. The Farm Credit System Reform Act of 1996 expanded Farmer Mac's role from a guarantor of securities backed by loan pools to 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.

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, 2006, totaled \$7.1 billion. That volume represents an increase of 38 percent from program activity at September 30, 2005. Of total program activity, \$2.1 billion were on-balance sheet loans and agricultural mortgage-backed securities, and \$5.0 billion were off-balance sheet obligations. Total assets were \$4.9 billion at the close of the third quarter, with nonprogram investments accounting for \$2.7 billion of

those assets. Farmer Mac's net income for first three quarters of 2006 was \$23.9 million, a decrease of 39 percent from restated amounts for the same period in 2005.

In November 2006, Farmer Mac restated its financial results for 2005 and other periods to remove the impact of accounting for derivatives as hedges against interest rate movements. As a result, there could be significant fluctuation in net income in future periods. However, Farmer Mac does not expect the accounting change to impact its ability to carry out its business plans or have any effect on its business model.

### **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 Export Credit Guarantee Programs (also known as 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.

### **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 through the International Monetary Fund 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 six months in any 12-month period unless the President gives the Congress a written statement that unique or emergency circumstances require the loan or credit be for more than six 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. DCA provides non-sovereign 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.

### **Self-Sufficient Export-Import Bank**

The Budget estimates that the Bank’s export credit support will total \$18.7 billion, and will be funded entirely by receipts collected from the Bank’s customers. The Bank estimates it will collect \$146 million in 2008 in excess of expected losses on transactions authorized in 2008 and prior years. These amounts will be used to: (1) cover the estimated costs for that portion of new authorizations where fees are insufficient to cover expected losses; and (2) to cover administrative expenses.

## **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. Since its creation, the system has undergone a series of reforms, most recently in 2006.

While the deposit insurance system for banks and thrifts today is generally sound and well managed, inherent weaknesses in the system prompted the Administration to propose, and the Congress to enact, the Deposit Insurance Reform Act (part of the Deficit Re-

duction Act of 2005) in February 2006. This package of reforms had several effects: it consolidated the Federal Deposit Insurance Corporation’s (FDIC) insurance funds (the Bank Insurance Fund and Savings Association Insurance Fund) into a new Deposit Insurance Fund, set new parameters on how the consolidated fund would be managed, adjusted the way that premiums for deposit insurance were calculated to ensure that all banks would pay premiums for Federal insurance on their insured deposits, and allowed for an increase of the coverage limits for Federal deposit insurance. These new authorities allow the FDIC to better manage the Deposit Insurance Fund and help avoid strain on financial institutions by spreading the cost of deposit insurance over time instead of having a potential for sharp premium increases when the economy may be under stress. The FDIC issued several new regulations during 2006 to implement the reforms in 2007.

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 Deposit Insurance Reform Act of 2005, the deposit insurance ceiling for retirement accounts will be increased to \$250,000. In addition, beginning in 2010, and every five years thereafter, FDIC and NCUA will have the authority to increase deposit insurance coverage limits for retirement and non-retirement accounts based on inflation if the Boards of the FDIC and NCUA determine such an increase is warranted. As of September 30, 2006, FDIC insured \$4.1 trillion of deposits at 8,743 commercial banks and thrifts, and NCUA insured \$529 billion of deposits (shares) at 8,462 credit unions.

### **Current Industry Conditions**

The banking and thrift sector has been in the midst of a sustained run of record profits and strong balance sheets. During calendar year 2006, insured banks and thrifts continued to report record-high net earnings, with the industry's two highest-ever quarterly profits reported in the second and third quarters of 2006. In 2005 and 2006, no banks or thrifts failed—the longest period without a failure in the 73-year history of the FDIC. As of September 30, 2006, the FDIC classified 47 institutions with \$4 billion in assets as “problem institutions” (institutions with the highest risk ratings), a historical low both in the number of institutions and dollar-value of assets thus classified.

Despite these strong fundamentals, some risks remain. In particular, the residential real estate market has been showing signs of significant weakness in recent months, with several regional markets experiencing slower sales and stagnant or even falling property prices. According to the National Association of Realtors, U.S. median house prices stayed essentially flat during the second half of 2006, after four and half years when growth rates nationwide exceeded five percent. In addition, after the steady series of interest rate hikes by the Federal Reserve in 2005 and 2006, higher short-term interest rates are beginning to squeeze the interest margins of many banks (The interest margin is the difference between the interest rates the banks charge for loans and the interest rates that they pay to depositors).

This tightening has begun to erode the proceeds from banks' core business. Not only are higher interest rates squeezing banks, they are also squeezing borrowers. During the past few years, banks have issued an increasing number of non-traditional mortgages, i.e., loans that have adjustable payment terms that allow borrowers to have lower initial payments, while their overall debt burden stays constant or even increases. Studies have suggested that in the first half of 2006, as many as 30 percent of mortgages issued nationally were non-traditional. Federal regulators, including the Federal Reserve, Office of the Comptroller of the Cur-

rency (OCC), Office of Thrift Supervision (OTS), and FDIC, and industry analysts have been vocal in highlighting the spread of non-traditional lending products, and warned lenders and borrowers about the additional risks these products can pose if not properly managed. The regulators have raised these issues in testimony before Congress and in a variety of public forums, including guidance issued to the industry.

The Office of the Comptroller of the Currency has reported that, as competition in lending has intensified, banks have been easing their standards for extending loans to individuals and businesses. This has led to concerns about maintaining credit quality in the nation's lending markets. Separate, but related concerns have arisen in the area of “subprime” lending—loans to consumers with poor credit histories or who belong to groups that may not have previously had access to financing. This segment of the market has seen substantial growth in recent years, providing greater opportunity to these borrowers, but loans to subprime borrowers historically have higher rates of default. Although lenders charge higher rates of interest to subprime borrowers to compensate for the risk of default, with increased competition the spread (or additional interest charged) on subprime lending has fallen and may not fully cover the potential risk.

In order to address some of these potential problems, especially in non-traditional mortgages and easing lending standards, during 2006 the Federal banking regulators (the Board of Governors of the Federal Reserve System, the FDIC, the OCC, and the OTS) issued guidance to banks and thrifts on managing exposure to non-traditional mortgages, and on the appropriate disclosure to consumers of clear and balanced information about the risks of these products. The regulators also issued guidance on commercial real estate which sought to mitigate potential problems with rising concentrations of lending in commercial real estate, an issue of regulatory concern in a number of smaller and mid-sized community banks.

Also worthy of note is the increasing consolidation of the U.S. banking industry in recent years. As banks have merged or been acquired, the largest institutions have accounted for a growing share of total assets—whereas in 1984 depository institutions with over \$10 billion in assets accounted for 42 percent of total assets in the industry, by 2004 the share of those institutions had risen to 73 percent. This has enabled larger banks and other institutions to diversify more effectively and obtain financing from the capital markets, but it has also meant that the failure of a single large insured institution could put a significant strain on the resources of the Federal deposit insurance funds.

### **Recent Changes to Federal Deposit Insurance Funds**

Under the Deposit Insurance Reform Act of 2005, the FDIC's Bank Insurance Fund (BIF) and its Savings Association Insurance Fund (SAIF) were merged into the new Deposit Insurance Fund (DIF) in June 2006.

At the end of September 2006, the DIF reserve ratio (ratio of insurance reserves to insured deposits) stood at 1.22 percent—\$1.2 billion below the level that would meet the target reserve ratio. Under new authority provided by the passage of the Deposit Insurance Reform Act, the FDIC Board voted to establish a new set of premiums for the industry to recapitalize the DIF. The new premiums range from a minimum of five basis points (five cents per \$100 of assessable deposits) up to as high as 43 basis points based on the assessed risk of an institution. The Deposit Insurance Reform Act of 2005 provided depository institutions that had paid deposit insurance premiums prior to 1996 (the last year the FDIC collected premiums) with \$4.7 billion in credits toward premiums, most of which will likely be used by 2009. Taking these credits into consideration, the FDIC is expected to collect approximately \$1.5 billion in new revenue during fiscal 2007 and 2008 combined.

The National Credit Union Share Insurance Fund (NCUSIF), the Federal fund for credit unions that is analogous to the DIF for banks and thrifts, ended fiscal year 2006 with assets of \$6.7 billion and an equity ratio of 1.29 percent, approaching the NCUA-set target ratio of 1.30 percent. Over the past five years, the NCUSIF's equity ratio has gradually risen from about 1.27 percent, reflecting strong performance (and therefore few losses due to failures) in the credit union industry.

### Current Regulatory Issues

A number of major regulatory initiatives are currently underway in the banking sector, which are likely to have a significant impact on the banking sector as a whole and, by extension, on the Federal deposit insurance system. For example, the Federal banking regulators (the Federal Reserve, FDIC, OCC and OTS) continue to work on a rulemaking that would implement the "International Convergence of Capital Measurement and Capital Standards: A Revised Framework" ("Basel II").

Since equity capital serves as a cushion against potential losses, banks with riskier asset portfolios should hold more equity capital. The original Basel Capital Accord (Basel I) adopted in 1989 is an international accord among financial regulators establishing a uniform capital standard for banks across nations. Under Basel I, bank assets are grouped into a small number of broad risk categories. A bank's regulatory capital requirement is tied to the amount of its asset holdings in each risk category.

During 2006, the Federal banking regulators proposed two separate but related rulemakings to implement the Revised Basel Capital Accord: the "Basel II" framework and an intermediate "Basel 1A" framework.

In the proposed Basel II rule, U.S. regulators are considering requiring the ten or so largest banks (including those that have major international operations, complex financial structures and expertise) to use an advanced internal ratings-based approach to calculate

their credit risk capital requirements. The Basel II rulemaking would allow for greater sensitivity to risk in the portfolios banks hold. Rather than grouping assets into broad risk categories, capital requirements would be tied to banks' internal assessments of the likelihood and severity of default losses from the assets they hold. The rules are also intended to allow capital requirements to more accurately account for the benefits or risk-mitigation activities undertaken by banks. The rulemaking would also require banks to hold capital to cover operational risk, which is not covered under the existing (Basel I) requirements.

Implementation of the Basel II standard in Europe is scheduled to begin during 2007, more than a year before U.S. implementation would likely begin, and this delay has led to concerns about a competitive imbalance between U.S. and foreign banks. There are also concerns about competitive imbalance between U.S. banks, and for that reason, banks other than the ten largest U.S. banks would be able to choose between adopting the "Basel II" standard, the current "Basel I" system, and an alternative "Basel 1A" standard.

The "Basel 1A" standard is intended to be more risk-sensitive than Basel I, but easier to implement than Basel II. The "Basel 1A" standard would provide additional risk-sensitivity through use of external credit ratings, and internal risk measures for some types of assets (i.e., loan-to-value ratios for mortgages). This new standard would allow banks to potentially lower their capital requirements and provide small- and mid-sized banks a means to stay competitive with the larger Basel II banks. The regulators are proposing to make the Basel 1A standard optional for banks, meaning that no small or medium-sized bank would be required to change its capital regime.

The proposed text of both rules has been released for public comment, and regulators hope to finalize these rules in the near future.

### Pension Guarantees

The Pension Benefit Guaranty Corporation (PBGC) insures pension benefits of workers and retirees in covered defined-benefit pension plans sponsored by private-sector employers. PBGC pays benefits, up to a guaranteed level, 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 healthy firms become distressed and well-funded plans become underfunded due to inadequate contributions, poor investment results, or increased liabilities.

PBGC monitors companies with underfunded plans and acts to protect the interests of the pension insurance program's stakeholders where possible. Under its Early Warning Program, PBGC works with companies to strengthen plan funding or otherwise protect the in-

insurance program from avoidable losses. However, PBGC's authority to prevent undue risks to the insurance program is limited.

As a result of a flawed pension funding system and exposure to losses from financially troubled plan sponsors, PBGC's single-employer program incurred sub-

stantial losses from underfunded plan terminations in 2001 through 2006. The table below shows the ten largest plan termination losses in PBGC's history. Nine of the ten have come in the past five years. The program's deficit at 2006 year-end stood at \$18.1 billion<sup>1</sup> compared to a \$9.7 billion surplus at 2000 year-end.

#### LARGEST TEN CLAIMS AGAINST THE PBGC'S SINGLE-EMPLOYER INSURANCE PROGRAM, 1975-2006

Top 10 Firms	Fiscal Years of Plan Terminations	Claims (by firm)	Percent of Total Claims (1975-2005)
1. United Airlines .....	2005	\$7,484,348,482	22.90%
2. Bethlehem Steel .....	2003	3,654,380,116	11.20%
3. US Airways .....	2003, 2005	2,690,222,805	8.20%
4. LTV Steel * .....	2002, 2003, 2004	2,136,698,831	6.50%
5. National Steel .....	2003	1,275,628,286	3.90%
6. Pan American Air .....	1991, 1992	841,082,434	2.60%
7. Weirton Steel .....	2004	690,181,783	2.10%
8. Trans World Airlines .....	2001	668,377,105	2.00%
9. Kaiser Aluminum .....	2004	600,009,879	1.80%
10. Kemper Insurance .....	2005	568,417,151	1.70%
Top Ten Total .....		20,609,346,871	63.20%
All Other Total .....		12,017,433,400	36.80%
<b>TOTAL</b> .....		<b>\$32,626,780,271</b>	<b>100.00%</b>

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.

Sources: PBGC Fiscal Year Closing File (9/30/06), PBGC Case Administration System, and PBGC Participant System (PRISM).

In February 2005 the Administration proposed comprehensive reforms to address structural flaws in the statutory plan funding requirements and in the design of the insurance program. The proposal sought to strengthen funding for workers' defined-benefit pensions; provide more accurate information about pension liabilities and plan underfunding; and enable PBGC to meet its obligations to participants in terminated pension plans. Many of the President's reforms were incorporated into the Deficit Reduction Act (DRA) of 2005, enacted in February 2006, and the Pension Protection Act of 2006 (PPA), enacted in August 2006.

The legislation made significant structural changes to the retirement system. But while the PBGC has sufficient liquidity to meet its obligations for a number of years, neither the single-employer nor multiemployer program has the resources to satisfy fully the agency's long-term obligations to plan participants.

Further reforms are needed to address the \$19 billion gap that still exists between PBGC's liabilities and its assets. The Budget repropose non-enacted premium reforms from the Administration's comprehensive pension

reform proposal that were not included in the DRA or the PPA, including:

- Authorizing PBGC's Board of Directors to set the variable premium rate.
- Extending the variable rate premium to a plan's non-vested as well as its vested liabilities.

These reforms will improve PBGC's financial condition and safeguard the future benefits of American workers. The Administration is committed to pension reform that will ultimately restore the 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. By

<sup>1</sup>The 2006 year-end single-employer program deficit of \$18.1 billion was less than the \$22.8 billion deficit at the end of 2005. The improvement in PBGC's financial condition was driven primarily by the airline relief provisions in the Pension Protection Act of 2006,

which resulted in large plans previously classified as probable terminations being changed from the probable classification to the reasonably possible classification in FY 2006. This credit was partially offset by \$3.1 billion in financial losses.

the end of 2006, the program had over 5.3 million policies in more than 20,200 communities with over \$1 trillion 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. However, structures built prior to flood mapping and NFIP floodplain management requirements, which make up 26 percent of the total policies in force, pay less than fully actuarial rates.

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 nearly 14 percent in 2006 with nearly 660,000 new policies. The most significant participation increases were in vulnerable coastal states, such as Mississippi (58 percent, 25,371 policy increase), Texas (30 percent, 140,834 policy increase), Louisiana (25 percent, 98,096 policy increase), and Florida (11 percent, 208,716 policy increase). However, the program has also seen significant growth within some in-land states such as Idaho (24 percent, 1,357 policy increase), based on greater awareness of the need for flood insurance protection.

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 grant programs targeted toward repetitive and severe repetitive loss properties not only help owners of high-risk property, but also reduce the disproportionate drain on the National Flood Insurance Fund these properties cause through acquisition, relocation, or elevation. As a result of the 2005 hurricane season, the number of repetitive and severe repetitive loss properties increased significantly, and the Budget proposes to expand the severe repetitive loss grant program to mitigate the future impact of these high-risk properties. DHS is working 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 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, forcing the NFIP to borrow funds from the Treasury in order to meet claims obligations. However, since the program began in 1968 until 2005, the program has repaid all borrowed funds with interest. However, hurricanes Katrina, Rita, and Wilma generated more flood insurance claims than the cumulative number of claims from 1968 to 2004. These three storms resulted in over 234,000 claims with total claims payments expected to be approximately \$21 billion. As a result, the Administration and the Congress have increased the borrowing authority to \$20.8 billion to date in order to make certain that all claims could be paid.

The catastrophic nature of the 2005 hurricane season has also triggered an examination of the program, and the Administration has worked with the Congress to improve the program, 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. Although flood insurance reform was not achieved in 2006, the Administration looks forward to continuing to work with the Congress to enact program reforms that 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. The 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 a portion of 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 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 the 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 2009. 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; the development of revenue and livestock insurance, for example, has 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 catastrophic coverage (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. Higher levels of coverage, called buy-up coverage, are also available. A premium is charged for buy-up coverage. The premium is determined by the level of coverage selected and varies from crop to crop and county to county. For the 10 principal crops, which account for about 80 percent of total liability, the most recent data shows that over 75 percent of eligible acres participated in the crop insurance program.

RMA offers both yield and revenue-based insurance products. 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 or yield crop insurance by adding price variability to production history.

USDA is continuously trying to develop new products or expand existing products in order to cover more types of crops. In 2006, a Livestock Risk Protection for Lamb pilot was introduced, and Adjusted Gross Revenue-Lite was made available in five additional States. In addition, two new Group Risk Protection risk management tools for pasture, rangeland, and forage protection were approved for the 2007 crop year. These innovative pilot programs are based on vegetation greenness and rainfall indices and were developed to provide livestock producers the ability to purchase insurance protection for losses of forage produced for grazing or harvested for hay. RMA also expanded the Group Risk Income Protection plans for cotton, wheat, and grain sorghum for the 2007 crop year. And, it is expected that the Livestock Gross Margin pilot program will be expanded to include cattle in 2007. 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 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](http://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 (TRIA). 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 offering commercial property and casualty insurance policies 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 initially 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 any Federal payments via surcharges on policyholders in future years. In December 2005, the Congress passed and the President signed the Terrorism Risk Insurance Extension Act, which extended the program for two years, through December 31, 2007, and substantially narrowed the scope of the program.

The 2005 Act significantly reduced taxpayers’ exposure by excluding certain lines of insurance from Federal coverage: commercial automobile, burglary and theft, surety, professional liability, and farm owners multiple peril insurance were removed from the program altogether. In addition, the 2005 Act increased 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 decreased 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.

The new legislation also increased the trigger amount for Federal payments, from the original \$5 million in aggregate insured losses from an act of terrorism to

\$50 million in calendar year 2006 and \$100 million in calendar year 2007. TRIA imposes a cap of \$100 billion on total insurer losses from terrorist attacks that the Federal program would cover. Under the statute, the Congress would determine the procedures to govern any payments for losses beyond \$100 billion in separate legislation.

In addition to the reforms to the scope of the program, the 2005 Act required the President's Working Group on Financial Markets (PWG) to conduct a study on the availability and affordability of terrorism risk coverage under the program and to report the results to the Congress by September 30, 2006. The PWG report found that the program had achieved its goals of supporting the insurance industry post September 11, 2001 and that the market for terrorism risk insurance (in terms of availability and affordability) has improved since September 11, 2001. The TRIA program was never intended to be permanent, but rather was intended to help stabilize the insurance industry during a time of significant transition. It has been successful in providing a temporary transition to allow for greater market development.

#### **Airline War Risk Insurance**

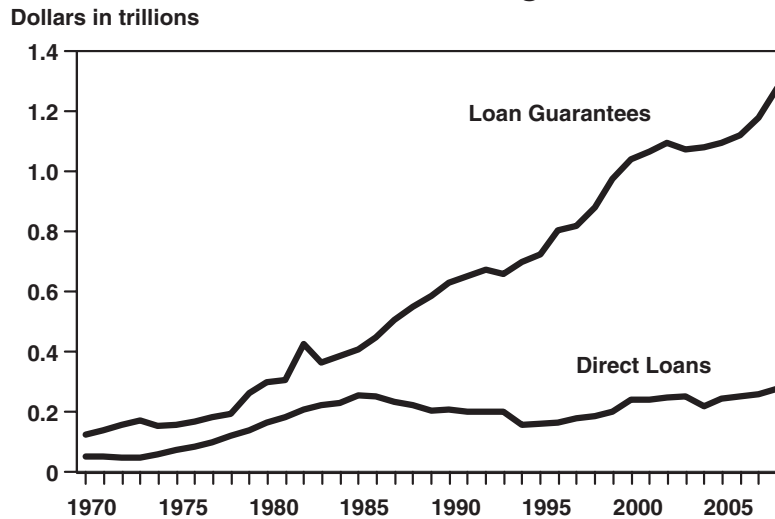
After the September 11, 2001 attacks, private insurers cancelled third-party liability war risk coverage for airlines and dramatically increased the cost of other war risk insurance. In addition to a number of short term responses, the Congress also passed the Homeland Security Act of 2002 (P.L. 107-296.) Among other provisions, this Act required the Secretary to provide additional war risk insurance coverage to air carriers insured for Third-Party War Risk Liability as of June 19, 2002, as authorized under existing law. The Continuing Appropriations Act for FY 2007, as amended (P.L. 109-383) further extended the requirement to provide insurance coverage through the duration of the resolution, February 15, 2007, and the program is expected to be continued through at least August 31, 2007. Acting on behalf of the Secretary, the FAA insurance policies made available under this Act cover: (i) hull losses at agreed value; (ii) death, injury, or property loss to passengers or crew, the limit being the

same as that of the air carrier's commercial coverage before September 11, 2001; and (iii) third party liability, the limit generally being twice that of such coverage. The Secretary is also authorized to limit an air carrier's third party liability to \$100 million, when the Secretary certifies that the loss is from an act of terrorism.

This program provides airlines with financial protection from war risk occurrences, and thus allows airlines to meet the basic requirement for "adequate liability coverage" found in most aircraft leases and in government regulation. Without such coverage, many airlines might be grounded. Currently, aviation war risk insurance coverage is generally available from private insurers, but premiums are significantly higher in the private market. Private insurance is also available for third-party liability and for occurrences involving weapons of mass destruction, albeit to a lesser extent.

Currently 75 air carriers are insured by the Department of Transportation. 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 for these policies are deposited into the Aviation Insurance Revolving Fund. In 2006, the Fund earned approximately \$169 million in premiums for insurance provided by DOT, and it is anticipated that an additional \$99 million in premiums will be earned in 2007. At the end of 2006, the balance in the Aviation Insurance Revolving Fund available for payment of future claims was \$742 million. Although no claims have been paid by the Fund since 2001, the balance in the Fund would be inadequate to meet either the coverage limits of the largest policies in force (\$4 billion) or to meet a series of large claims in succession. 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. The Administration is committed to working with the Congress to reform this program, and to ensure that air carriers more equitably share in the risks associated with this program.

**Chart 7-2. Face Value of Federal Credit Outstanding**



**TABLE 7-1. ESTIMATED FUTURE COST OF OUTSTANDING FEDERAL CREDIT PROGRAMS**

(In billions of dollars)

Program	Outstanding 2005	Estimated Future Costs of 2005 Outstanding <sup>1</sup>	Outstanding 2006	Estimated Future Costs of 2006 Outstanding <sup>1</sup>
<b>Direct Loans:<sup>2</sup></b>				
Federal Student Loans .....	113	11	116	16
Farm Service Agency (excl. CCC), Rural Development, Rural Housing .....	43	9	43	10
Rural Utilities Service and Rural Telephone Bank .....	34	2	38	2
Housing and Urban Development .....	12	2	11	3
Export-Import Bank .....	10	5	7	2
Public Law 480 .....	9	4	8	4
Agency for International Development .....	8	3	7	3
Commodity Credit Corporation .....	3	1	2	1
Disaster Assistance .....	4	1	7	2
VA Mortgage .....	1	.....	1	.....
Other Direct Loan Programs .....	11	3	12	4
<b>Total Direct Loans .....</b>	<b>247</b>	<b>41</b>	<b>251</b>	<b>47</b>
<b>Guaranteed Loans:<sup>2</sup></b>				
FHA Mutual Mortgage Insurance Fund .....	336	2	317	3
VA Mortgage .....	206	3	211	3
Federal Student Loans .....	289	31	325	52
FHA General/Special Risk Insurance Fund .....	90	3	98	1
Small Business <sup>3</sup> .....	73	2	67	2
Export-Import Bank .....	36	2	36	2
International Assistance .....	22	2	22	2
Farm Service Agency (excl. CCC), Rural Development, Rural Housing .....	30	1	31	.....
Commodity Credit Corporation .....	2	.....	3	.....
Maritime Administration .....	3	.....	3	.....
Air Transportation Stabilization Program .....	1	1	.....	.....
Government National Mortgage Association (GNMA) <sup>3</sup> .....	.....	*	.....	*
Other Guaranteed Loan Programs .....	8	1	6	1

**TABLE 7-1. ESTIMATED FUTURE COST OF OUTSTANDING FEDERAL CREDIT PROGRAMS—  
Continued**

(In billions of dollars)

Program	Outstanding 2005	Estimated Future Costs of 2005 Outstanding <sup>1</sup>	Outstanding 2006	Estimated Future Costs of 2006 Outstanding <sup>1</sup>
Total Guaranteed Loans .....	1,096	48	1,120	66
<b>Total Federal Credit .....</b>	<b>1,343</b>	<b>89</b>	<b>1,371</b>	<b>113</b>

\* \$500 million or less.

<sup>1</sup> 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.

<sup>2</sup> 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.

<sup>3</sup> GNMA data are excluded from the totals because they are secondary guarantees on loans guaranteed by FHA, VA and RHS. Certain SBA data are excluded from the totals because they are secondary guarantees on SBA's own guaranteed loans.

Table 7-2. REESTIMATES OF CREDIT SUBSIDIES ON LOANS DISBURSED BETWEEN 1992-2006 <sup>1</sup>

(Budget authority and outlays, in millions of dollars)

Program	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
<b>DIRECT LOANS:</b>												
<b>Agriculture:</b>												
Agriculture credit insurance fund .....	2	-31	23	.....	331	-656	921	10	-701	-147	-2	-14
Farm storage facility loans .....	.....	.....	.....	.....	.....	.....	-1	-7	-8	7	-1	.....
Apple loans .....	.....	.....	.....	.....	.....	.....	-2	1	.....	*	*	*
Emergency boll weevil loan .....	.....	.....	.....	.....	.....	.....	.....	1	*	*	3	.....
Distance learning and telemedicine .....	.....	.....	.....	.....	.....	.....	1	-1	-1	1	7	.....
Rural electrification and telecommunications loans .....	-37	84	.....	-39	.....	-17	-42	101	265	143	-197	.....
Rural telephone bank .....	.....	10	.....	-9	.....	-1	.....	-3	-7	-6	-17	.....
Rural housing insurance fund .....	46	-73	.....	71	.....	19	-29	-435	-64	-200	109	.....
Rural economic development loans .....	.....	1	.....	-1	*	.....	-1	-1	.....	-2	*	.....
Rural development loan program .....	.....	.....	.....	-6	.....	.....	-1	-3	.....	-3	-2	.....
Rural community advancement program <sup>2</sup> .....	.....	8	.....	5	.....	37	3	-1	-84	-34	-73	.....
P.L. 480 .....	-37	-1	.....	.....	.....	-23	65	-348	33	-43	-239	-26
P.L. 480 Title I food for progress credits .....	-38	.....	.....	.....	.....	.....	.....	-112	-44	.....	.....	.....
<b>Commerce:</b>												
Fisheries finance .....	.....	.....	.....	.....	.....	-19	-1	-3	.....	1	-15	-12
<b>Defense:</b>												
Military housing improvement fund .....	.....	.....	.....	.....	.....	.....	.....	.....	.....	*	-4	-1
<b>Education:</b>												
Federal direct student loan program: <sup>3</sup>	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
Volume reestimate .....	.....	.....	.....	22	.....	-6	.....	43	.....	.....	.....	.....
Other technical reestimate .....	3	-83	172	-383	-2,158	560	.....	3,678	1,999	855	2,827	2,674
College housing and academic facilities loans .....	.....	.....	.....	.....	.....	-1	.....	.....	.....	.....	.....	11
<b>Homeland Security:</b>												
Disaster assistance .....	.....	.....	.....	.....	47	36	-7	-6	*	4	*	*
<b>Interior:</b>												
Bureau of Reclamation loans .....	.....	.....	.....	.....	3	3	-9	-14	.....	17	1	*
Bureau of Indian Affairs direct loans .....	.....	.....	.....	1	5	-1	-1	2	*	*	*	1
Assistance to American Samoa .....	.....	.....	.....	.....	.....	.....	.....	.....	*	*	.....	2
<b>State</b>												
Repatriation loans .....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	-4
<b>Transportation:</b>												
High priority corridor loans .....	.....	.....	-3	.....	.....	.....	.....	.....	.....	.....	.....	.....
Alameda corridor loan .....	.....	.....	.....	.....	-58	.....	.....	.....	-12	.....	.....	.....
Transportation infrastructure finance and innovation ..	.....	.....	.....	.....	.....	18	.....	.....	.....	3	-11	7
Railroad rehabilitation and improvement program .....	.....	.....	.....	.....	.....	.....	.....	.....	-5	-14	-11	-1
<b>Treasury:</b>												
Community development financial institutions fund .....	.....	.....	.....	.....	1	.....	.....	*	-1	*	-1	1
<b>Veterans Affairs:</b>												
Veterans housing benefit program fund .....	76	-72	465	-111	-52	-107	-697	17	-178	987	-44	-76
Native American veteran housing .....	.....	.....	.....	.....	.....	.....	.....	-3	*	*	*	1
Vocational Rehabilitation Loans .....	.....	.....	.....	.....	.....	.....	.....	*	*	*	-1	1
<b>Environmental Protection Agency:</b>												
Abatement, control and compliance .....	.....	.....	.....	.....	.....	3	-1	*	-3	*	*	*
<b>International Assistance Programs:</b>												
Foreign military financing .....	.....	13	4	1	152	-166	119	-397	-64	-41	-7	-6
U.S. Agency for International Development:	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
Micro and small enterprise development .....	.....	.....	.....	.....	.....	.....	*	.....	*	.....	.....	.....
Overseas Private Investment Corporation:	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
OPIC direct loans .....	.....	.....	.....	.....	.....	.....	.....	-4	-21	3	-7	72
Debt reduction .....	.....	.....	.....	.....	36	-4	.....	*	-47	-104	54	-3
<b>Small Business Administration:</b>												
Business loans .....	.....	.....	.....	.....	.....	1	-2	1	25	.....	-16	-4
Disaster loans .....	.....	.....	-193	246	-398	-282	-14	266	589	196	61	258
<b>Other Independent Agencies:</b>												
Export-Import Bank direct loans .....	37	.....	.....	.....	-177	157	117	-640	-305	111	-257	-227
Federal Communications Commission .....	.....	.....	4,592	980	-1,501	-804	92	346	380	732	-24	11
<b>LOAN GUARANTEES:</b>												
<b>Agriculture:</b>												
Agriculture credit insurance fund .....	12	-51	96	.....	-31	205	40	-36	-33	-22	-162	20

Table 7-2. REESTIMATES OF CREDIT SUBSIDIES ON LOANS DISBURSED BETWEEN 1992-2006 <sup>1</sup>—Continued

(Budget authority and outlays, in millions of dollars)

Program	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Agriculture resource conservation demonstration .....						2		1	-1	*	*	
Commodity Credit Corporation export guarantees .....	-426	343				-1,410		-13	-230	-205	-366	-232
Rural development insurance fund .....		-3									34	
Rural housing insurance fund .....	7	-10		109		152	-56	32	50	66	44	
Rural community advancement program <sup>2</sup> .....		-10		41		63	17	91	15	29	-64	
<b>Commerce:</b>												
Fisheries finance .....			-2			-3	-1	3	*	1	*	1
Emergency steel guaranteed loans .....								50	*	3	-75	-13
Emergency oil and gas guaranteed loans .....						*	*	*	*	*	-1	*
<b>Defense:</b>												
Military housing improvement fund .....									-3	-1	-3	-5
Defense export loan guarantee .....										-5		
Arms initiative guaranteed loan program .....												20
<b>Education:</b>												
Federal family education loan program: <sup>3</sup>												
Volume reestimate .....	535	99		-13	-60	-42		277				
Other technical reestimate .....	60			-140	667	-3,484		-2,483	-3,278	1,348	6,837	-3,399
<b>Health and Human Services:</b>												
Health center loan guarantees .....					3		*	*		1	*	*
Health education assistance loans .....								-5	-37	-33	-18	-20
<b>Housing and Urban Development:</b>												
Indian housing loan guarantee .....						-6	*	-1	*	-3	-1	*
Title VI Indian guarantees .....								-1	1	4	*	-4
Community development loan guarantees .....									19	-10	-2	4
FHA-mutual mortgage insurance .....		-340		3,789		2,413	-1,308	1,100	5,947	1,979	2,842	636
FHA-general and special risk .....	-110	-25	743	79		-217	-403	77	352	507	238	-1,254
<b>Interior:</b>												
Bureau of Indian Affairs guaranteed loans .....		31				-14	-1	-2	-2	*	15	5
<b>Transportation:</b>												
Maritime guaranteed loans (Title XI) .....				-71	30	-15	187	27	-16	4	-76	-11
Minority business resource center .....							1		*	*		*
<b>Treasury:</b>												
Air transportation stabilization program .....								113	-199	292	-109	-38
<b>Veterans Affairs:</b>												
Veterans housing benefit fund program .....	334	-706	38	492	229	-770	-163	-184	-1,515	-462	-842	-525
<b>International Assistance Programs:</b>												
U.S. Agency for International Development:												
Development credit authority .....							-1		1	-3	-2	2
Micro and small enterprise development .....									2	-2		-3
Urban and environmental credit .....	-7		-14				-4	-15	48	-2	-5	-11
Assistance to the new independent states of the former Soviet Union .....							-34					
Loan Guarantees to Israel .....									-76	-111	188	34
Loan Guarantees to Egypt .....											7	14
Overseas Private Investment Corporation:												
OPIC guaranteed loans .....							5	77	60	-212	-21	-149
<b>Small Business Administration:</b>												
Business loans .....	257	-16	-279	-545	-235	-528	-226	304	1,750	1,034	-390	-268
<b>Other Independent Agencies:</b>												
Export-Import Bank guarantees .....	13				-191	-1,520	-417	-2,042	-1,133	-655	-1,164	-579
<b>Total</b> .....	727	-832	5,642	4,518	-3,641	-6,427	-1,854	-142	3,468	6,008	9,037	-3,111

\* Less than \$500,000.

<sup>1</sup>Excludes interest on reestimates. Additional information on credit reform subsidy rates is contained in the Federal Credit Supplement.<sup>2</sup>Includes rural water and waste disposal, rural community facilities, and rural business and industry programs.<sup>3</sup>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, 2006-2008**

(In millions of dollars)

Agency and Program	2006 Actual			2007 Estimate			2008 Proposed		
	Subsidy rate <sup>1</sup>	Subsidy budget authority	Loan levels	Subsidy rate <sup>1</sup>	Subsidy budget authority	Loan levels	Subsidy rate <sup>1</sup>	Subsidy budget authority	Loan levels
<b>Agriculture:</b>									
Agricultural credit insurance fund .....	8.03	80	989	9.47	94	995	9.88	97	977
Farm storage facility loans .....	-0.62	-1	111	0.25	.....	74	1.12	1	93
Rural community advancement program .....	5.90	83	1,406	9.00	90	1,009	.....	.....	.....
Rural electrification and telecommunications loans .....	-0.50	-31	6,080	-0.71	-38	5,377	-0.51	-24	4,790
Distance learning, telemedicine, and broadband program .....	2.14	7	333	1.94	22	1,155	2.15	6	300
Rural water and waste disposal .....	.....	.....	.....	.....	.....	.....	14.20	153	1,080
Rural community facility .....	.....	.....	.....	.....	.....	.....	5.55	17	302
Rural housing assistance grants .....	46.76	2	4	47.82	4	8	.....	.....	.....
Farm labor .....	44.59	9	20	47.95	5	10	43.26	6	14
Multifamily housing revitalization .....	46.76	1	2	47.82	1	2	.....	.....	.....
Rural housing insurance fund .....	14.57	199	1,357	13.22	195	1,463	17.23	7	39
Rural development loan fund .....	43.02	15	34	44.07	15	33	42.89	14	34
Rural economic development loans .....	19.97	5	25	21.84	5	23	22.59	7	33
Public law 480 title I direct credit and food for progress .....	67.92	27	39	.....	.....	.....	.....	.....	.....
<b>Commerce:</b>									
Fisheries finance .....	-3.34	-4	138	-6.21	-5	75	-10.58	-1	8
<b>Defense—Military:</b>									
Defense family housing improvement fund .....	2.56	2	78	28.40	251	883	26.38	61	233
<b>Education:</b>									
College housing and academic facilities loans .....	.....	.....	15	57.72	179	310	.....	.....	.....
Federal direct student loan program .....	4.98	1,807	36,305	2.43	474	19,503	2.35	509	21,636
<b>Health and Human Services:</b>									
State grants and demonstrations .....	100.00	140	140	100.00	1	1	.....	.....	.....
<b>Homeland Security:</b>									
Disaster assistance direct loan .....	75.00	953	1,271	1.18	.....	25	1.73	.....	25
<b>Housing and Urban Development:</b>									
FHA-mutual mortgage insurance .....	.....	.....	3	.....	.....	50	.....	.....	50
<b>State:</b>									
Repatriation loans .....	64.99	1	1	60.14	1	1	60.22	1	1
<b>Transportation:</b>									
Federal-aid highways .....	8.50	4	42	5.05	121	2,400	5.00	79	1,581
Railroad rehabilitation and improvement program .....	.....	.....	155	.....	.....	200	.....	.....	600
<b>Treasury:</b>									
Community development financial institutions fund .....	37.47	.....	1	37.47	1	3	37.52	1	2
<b>Veterans Affairs:</b>									
Housing .....	2.27	3	163	5.25	18	335	3.86	20	539
Native American veteran housing loan .....	-13.79	-1	4	-13.46	-1	4	-14.48	-1	4
General operating expenses .....	1.59	.....	3	2.00	.....	3	2.16	.....	3
<b>International Assistance Programs:</b>									
Debt restructuring .....	.....	29	.....	.....	84	.....	.....	255	.....
Overseas Private Investment Corporation .....	3.63	7	193	2.74	10	350	3.22	16	500
<b>Small Business Administration:</b>									
Disaster loans .....	14.64	1,286	8,785	17.73	471	2,659	16.27	173	1,064
Business loans .....	7.17	1	20	10.21	1	10	.....	.....	25
<b>Export-Import Bank of the United States:</b>									
Export-Import Bank loans .....	1.79	1	56	34.00	17	50	33.01	17	50
<b>Total .....</b>	<b>N/A</b>	<b>4,625</b>	<b>57,773</b>	<b>N/A</b>	<b>2,016</b>	<b>37,011</b>	<b>N/A</b>	<b>1,414</b>	<b>33,983</b>

<sup>1</sup> 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, 2006-2008

(In millions of dollars)

Agency and Program	2006 Actual			2007 Estimate			2008 Proposed		
	Subsidy rate <sup>1</sup>	Subsidy budget authority	Loan levels	Subsidy rate <sup>1</sup>	Subsidy budget authority	Loan levels	Subsidy rate <sup>1</sup>	Subsidy budget authority	Loan levels
<b>Agriculture:</b>									
Agricultural credit insurance fund .....	3.12	67	2,147	2.39	65	2,624	2.54	62	2,450
Commodity Credit Corporation export loans .....	4.88	71	1,453	3.00	61	1,990	2.63	63	2,440
Rural community advancement program .....	3.99	38	933	4.02	48	1,197	.....	.....	.....
Rural water and waste disposal .....	.....	.....	.....	.....	.....	.....	-0.82	-1	75
Rural community facility .....	.....	.....	.....	.....	.....	.....	3.68	8	210
Rural housing insurance fund .....	1.29	41	3,173	1.26	62	4,998	0.57	29	5,049
Rural business and industry .....	.....	.....	.....	.....	.....	.....	4.32	43	1,000
Rural business investment .....	7.72	2	24	.....	.....	.....	.....	.....	.....
Renewable energy .....	6.45	2	24	6.49	10	154	9.69	19	195
<b>Education:</b>									
Federal family education loan .....	12.74	17,274	135,576	6.65	5,860	88,062	3.88	3,861	99,481
<b>Energy:</b>									
Title 17 innovative technology loan guarantee program .....	.....	.....	.....	.....	.....	.....	.....	.....	9,000
<b>Health and Human Services:</b>									
Health resources and services .....	3.50	.....	2	3.42	.....	8	.....	.....	.....
<b>Housing and Urban Development:</b>									
Indian housing loan guarantee fund .....	2.42	5	190	2.35	5	251	2.42	6	367
Native Hawaiian Housing Loan Guarantee Fund .....	.....	.....	.....	2.35	1	43	2.42	1	41
Native American housing block grant .....	12.26	2	13	11.99	2	17	12.12	2	17
Community development loan guarantees .....	2.20	5	220	2.17	3	136	2.20	1	45
FHA-mutual mortgage insurance .....	-1.70	-880	51,783	-0.37	-164	44,418	-0.83	-680	81,996
FHA-general and special risk .....	-1.74	-504	28,702	-2.01	-413	20,499	-2.54	-242	9,514
<b>Interior:</b>									
Indian guaranteed loan .....	4.75	5	117	6.45	5	87	6.52	5	86
<b>Transportation:</b>									
Minority business resource center program .....	1.85	.....	2	1.82	.....	18	2.03	.....	18
Federal-aid highways .....	.....	.....	.....	3.90	8	200	5.90	12	200
Railroad rehabilitation and improvement program .....	.....	.....	.....	.....	.....	.....	.....	.....	100
Maritime guaranteed loan (title XI) .....	.....	.....	.....	5.93	4	67	.....	.....	.....
<b>Veterans Affairs:</b>									
Housing .....	-0.32	-73	23,500	-0.36	-102	28,260	-0.37	-108	29,104
<b>International Assistance Programs:</b>									
Loan guarantees to Israel .....	.....	.....	.....	.....	.....	1,000	.....	.....	1,000
Development credit authority .....	3.66	6	159	5.45	6	110	6.03	21	348
Overseas Private Investment Corporation .....	-1.96	-13	661	-1.22	-12	950	-0.78	-8	950
<b>Small Business Administration:</b>									
Business loans .....	.....	.....	19,936	.....	.....	28,000	.....	.....	28,000
<b>Export-Import Bank of the United States:</b>									
Export-Import Bank loans .....	1.16	141	12,094	0.06	10	15,860	-1.95	-367	18,714
<b>Total</b> .....	<b>N/A</b>	<b>16,189</b>	<b>280,709</b>	<b>N/A</b>	<b>5,459</b>	<b>238,949</b>	<b>N/A</b>	<b>2,727</b>	<b>290,400</b>
<b>ADDENDUM: SECONDARY GUARANTEED LOAN COMMITMENT LIMITATIONS</b>									
<b>GNMA:</b>									
Guarantees of mortgage-backed securities loan guarantee .....	-0.23	-188	81,739	-0.21	-181	86,000	-0.27	-209	77,400
<b>SBA:</b>									
Secondary market guarantee .....	.....	.....	3,633	.....	.....	12,000	.....	.....	12,000
<b>Total, secondary guaranteed loan commitments</b> .....	<b>N/A</b>	<b>-188</b>	<b>85,372</b>	<b>N/A</b>	<b>-181</b>	<b>98,000</b>	<b>N/A</b>	<b>-209</b>	<b>89,400</b>

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



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

(In billions of dollars)

	Actual								Estimate	
	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
<b>Direct Loans:</b>										
Obligations .....	38.4	37.1	39.1	43.7	45.4	42.0	56.3	57.8	37.0	34.0
Disbursements .....	37.7	35.5	37.1	39.6	39.7	38.7	50.6	46.6	31.4	32.9
New subsidy budget authority .....	1.6	(0.4)	0.3	*	0.7	0.4	2.1	4.7	2.0	1.4
Reestimated subsidy budget authority <sup>1</sup> .....	1.0	(4.4)	(1.8)	0.5	2.9	2.6	3.8	3.1	3.6	.....
Total subsidy budget authority .....	2.6	(4.8)	(1.5)	0.5	3.5	3.0	6.0	7.8	5.5	1.4
<b>Loan guarantees:</b>										
Commitments <sup>2</sup> .....	252.4	192.6	256.4	303.7	345.9	300.6	248.5	280.7	239.0	290.4
Lender disbursements <sup>2</sup> .....	224.7	180.8	212.9	271.4	331.3	279.9	221.6	256.0	210.1	256.0
New subsidy budget authority .....	*	3.6	2.3	2.9	3.8	7.3	10.1	17.2	5.2	2.4
Reestimated subsidy budget authority <sup>1</sup> .....	4.3	0.3	(7.1)	(2.4)	(3.5)	2.0	3.5	7.0	(6.8)	.....
Total subsidy budget authority .....	4.3	3.9	(4.8)	0.5	0.3	9.3	13.6	24.2	(1.6)	2.4

\* Less than \$50 million.

<sup>1</sup> Includes interest on reestimate.<sup>2</sup> 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 WRITEOFFS AND GUARANTEED LOAN TERMINATIONS FOR DEFAULTS

Agency and Program	In millions of dollars			As a percentage of outstanding loans <sup>1</sup>		
	2006 Actual	2007 Estimate	2008 Estimate	2006 Actual	2007 Estimate	2008 Estimate
<b>DIRECT LOAN WRITEOFFS</b>						
Agriculture:						
Agricultural credit insurance fund .....	45	78	70	0.67	1.21	1.15
Commodity Credit Corporation fund .....			-1			-0.05
Rural community advancement program .....	9	4	4	0.10	0.04	0.03
Rural electrification and telecommunications loans .....	9			0.02		
Rural development insurance fund .....	1	1	1	0.05	0.05	0.06
Rural housing insurance fund .....	90	99	112	0.36	0.40	0.45
Rural development loan fund .....	3	2	1	0.69	0.45	0.21
Debt restructuring .....	130			24.95		
Commerce:						
Economic development revolving fund .....	1	1		10.00	14.28	
Education:						
Student financial assistance .....	14	14		4.33	4.34	
Perkins loan assets .....			54			
Housing and Urban Development:						
Revolving fund (liquidating programs) .....		1	1		16.66	25.00
Guarantees of mortgage-backed securities .....	4	24	20	40.00	342.85	285.71
Interior:						
Indian direct loan .....		1	1		4.34	5.00
Labor:						
Pension benefit guaranty corporation fund .....	87	93	93			
Veterans Affairs:						
Veterans housing benefit program .....	31	3	3	3.07	0.33	0.25
International Assistance Programs:						
Debt restructuring .....		2	29		0.81	12.03
Overseas Private Investment Corporation .....	15	6	15	2.41	0.82	1.78
Small Business Administration:						
Disaster loans .....	107	33	61	2.93	0.48	0.85
Business loans .....	2	2	2	1.09	1.11	1.28
Other Independent Agencies:						
Debt reduction (ExIm Bank) .....	776	58	107	73.34	19.07	42.29
Export-Import Bank .....	1,112	36	36	12.43	0.58	0.67
Spectrum auction program .....		50	150		11.70	41.89
Tennessee Valley Authority fund .....	1	1	1	2.08	1.92	1.72
<b>Total, direct loan writeoffs .....</b>	<b>2,437</b>	<b>509</b>	<b>760</b>	<b>1.11</b>	<b>0.22</b>	<b>0.32</b>
<b>GUARANTEED LOAN TERMINATIONS FOR DEFAULT</b>						
Agriculture:						
Agricultural credit insurance fund .....	37	48	48	0.35	0.47	0.45
Commodity Credit Corporation export loans .....	24	52	61	0.97	1.72	1.91
Rural community advancement program .....	115	135	158	2.44	3.01	3.41
Rural housing insurance fund .....	249	107	242	1.69	0.68	1.52
Commerce:						
Fisheries finance .....	4			12.50		
Defense—Military:						
Procurement of ammunition, Army .....	11	15		42.30	78.94	
Family housing improvement fund .....		7	7		1.40	1.43
Education:						
Federal family education loans .....	5,614	6,962	7,671	1.94	2.14	2.12
Health and Human Services:						
Health education assistance loans .....	16	24	21	0.93	1.74	1.92
Health center loan guarantees .....		1			2.63	
Housing and Urban Development:						
Indian housing loan guarantee .....	1	1	1	0.52	0.27	0.17
Native American housing block grant .....		2	2		2.40	2.17
FHA—Mutual mortgage insurance .....	5,381	5,722	6,250	1.60	1.80	1.98
FHA—General and special risk .....	1,034	1,535	1,767	1.15	1.57	1.78

Table 7-6. DIRECT LOAN WRITEOFFS AND GUARANTEED LOAN TERMINATIONS FOR DEFAULTS—Continued

Agency and Program	In millions of dollars			As a percentage of outstanding loans <sup>1</sup>		
	2006 Actual	2007 Estimate	2008 Estimate	2006 Actual	2007 Estimate	2008 Estimate
Interior:						
Indian guaranteed loans .....	1	5	5	0.31	1.57	1.47
Transportation:						
Maritime guaranteed loans (Title XI) .....		35	32		1.19	1.16
Veterans Affairs:						
Veterans housing benefit program .....	2,207	5,792	5,382	1.07	2.74	2.36
International Assistance Programs:						
Micro and small enterprise development .....	1		1	7.14		16.66
Urban and environmental credit program .....	32	11	12	1.93	0.72	0.86
Development credit authority .....		2	2		0.98	0.73
Overseas Private Investment Corporation .....	118	200	55	3.28	4.94	1.22
Small Business Administration:						
Business loans .....	1,200	1,141	1,151	1.63	1.69	1.60
Other Independent Agencies:						
Export-Import Bank .....	217	225	225	0.60	0.61	0.58
<b>Total, guaranteed loan terminations for default .....</b>	<b>16,262</b>	<b>22,022</b>	<b>23,093</b>	<b>1.07</b>	<b>1.43</b>	<b>1.44</b>
<b>Total, direct loan writeoffs and guaranteed loan terminations .....</b>	<b>18,699</b>	<b>22,531</b>	<b>23,853</b>	<b>1.08</b>	<b>1.28</b>	<b>1.30</b>
<b>ADDENDUM: WRITEOFFS OF DEFAULTED GUARANTEED LOANS THAT RESULT IN LOANS RECEIVABLE</b>						
Agriculture:						
Agricultural credit insurance fund .....	3	5	7	5.76	7.81	10.00
Commerce:						
Fisheries finance .....	5			13.88		
Education:						
Federal family education loans .....	990	1,121	1,185	4.40	4.57	4.70
Housing and Urban Development:						
FHA—Mutual mortgage insurance .....		9	1		2.25	1.69
FHA—General and special risk .....	276	25	22	6.23	0.51	0.35
Interior:						
Indian guaranteed loans .....	1	2	2	7.69	11.11	10.00
Treasury:						
Air transportation stabilization guaranteed loans .....	39	54		31.20	72.00	
International Assistance Programs:						
Overseas Private Investment Corporation .....	1	8	11	0.46	2.29	2.98
Small Business Administration:						
Business loans .....	1,012	281	279	19.04	5.52	5.35
Pollution control equipment .....	8			40.00		
Other Independent Agencies:						
Export-Import Bank .....	4			3.41		
<b>Total, writeoffs of loans receivable .....</b>	<b>2,339</b>	<b>1,505</b>	<b>1,507</b>	<b>6.18</b>	<b>3.85</b>	<b>3.72</b>

<sup>1</sup> Average of loans outstanding for the year.

Table 7-7. APPROPRIATIONS ACTS LIMITATIONS ON CREDIT LOAN LEVELS <sup>1</sup>

(In millions of dollars)

Agency and Program	2006 Actual	2007 Estimate	2008 Estimate
<b>DIRECT LOAN OBLIGATIONS</b>			
Agriculture:			
Agricultural credit insurance fund .....	936	933	917
P.L. 480 .....	39		
Commerce:			
Fisheries finance .....	138	75	8
Education:			
Historically black college and university capital financing .....	208	216	
Homeland Security:			
Disaster assistance .....	1,270	25	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
Transportation:			
Railroad rehabilitation and improvement direct loans .....			600
Treasury:			
Community development financial institutions fund .....	11	8	6
Veterans Affairs:			
Vocational rehabilitation .....	3	3	3
Native American loans .....	30	30	
Small Business Administration:			
Business loans .....	20	10	25
<b>Total, limitations on direct loan obligations .....</b>	<b>2,756</b>	<b>1,401</b>	<b>1,685</b>
<b>LOAN GUARANTEE COMMITMENTS</b>			
Agriculture:			
Agricultural credit insurance fund .....	2,147	2,622	2,450
Energy:			
Title 17 innovative technology loan guarantees .....			9,000
Housing and Urban Development:			
Indian housing loan guarantee fund .....	116	158	367
Title VI Indian Federal guarantees .....	17	17	17
Native Hawaiian Housing Loan Guarantee Fund .....	36	36	41
Community development loan guarantees .....	135	136	
FHA-general and special risk .....	35,000	35,000	35,000
FHA-mutual mortgage insurance .....	185,000	185,000	185,000
Interior:			
Indian guaranteed and insured loans .....	117	87	86
Transportation:			
Minority business resource center .....	18	18	18
Railroad rehabilitation and improvement loan guarantees .....			100
International Assistance Programs:			
Development credit authority .....	700		700
Small Business Administration:			
Business loans .....	19,936	28,000	28,000
<b>Total, limitations on loan guarantee commitments .....</b>	<b>243,222</b>	<b>251,074</b>	<b>260,779</b>
<b>ADDENDUM: SECONDARY GUARANTEED LOAN COMMITMENT LIMITATIONS</b>			
Housing and Urban Development:			
Guarantees of mortgage-backed securities .....	200,000	100,000	100,000
Small Business Administration:			
Secondary market guarantees .....	12,000	12,000	12,000

**Table 7-7. APPROPRIATIONS ACTS LIMITATIONS ON CREDIT LOAN LEVELS <sup>1</sup>—Continued**

(In millions of dollars)

Agency and Program	2006 Actual	2007 Estimate	2008 Estimate
<b>Total, limitations on secondary guaranteed loan commitments .....</b>	212,000	112,000	112,000

<sup>1</sup> 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 <sup>1</sup>**  
(In billions of dollars)

	Outstanding	
	2005	2006
<b>Government Sponsored Enterprises</b>		
Fannie Mae <sup>2</sup> .....	N/A	N/A
Freddie Mac <sup>3</sup> .....	N/A	N/A
Federal Home Loan Banks .....	574	621
Farm Credit System .....	92	105
<b>Total</b> .....	<b>N/A</b>	<b>N/A</b>

N/A = Not available.

<sup>1</sup> Net of purchases of federally guaranteed loans.

<sup>2</sup> Financial data for Fannie Mae is not presented here because following a restatement of financial data for 2001–2004, audited financial results for 2005 and 2006 have not been released.

<sup>3</sup> Financial data for Freddie Mac is not presented here because following the release of previous earnings restatements, audited financial statements for 2005 and 2006 have not been released.

**Table 7-9. LENDING AND BORROWING BY GOVERNMENT-SPONSORED ENTERPRISES (GSEs) <sup>1</sup>**

(In millions of dollars)

Enterprise	2006
<b>LENDING</b>	
Federal National Mortgage Association: <sup>2</sup>	
Portfolio programs:	
Net change .....	N/A
Outstandings .....	N/A
Mortgage-backed securities:	
Net change .....	N/A
Outstandings .....	N/A
Federal Home Loan Mortgage Corporation: <sup>3</sup>	
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 .....	3,642
Outstandings .....	28,763
Farm credit banks:	
Net change .....	9,383
Outstandings .....	76,185
Federal Agricultural Mortgage Corporation:	
Net change .....	1,933
Outstandings .....	7,059
Federal Home Loan Banks: <sup>4</sup>	
Net change .....	21,302
Outstandings .....	743,855
Less guaranteed loans purchased by:	
Federal National Mortgage Association: <sup>2</sup>	
Net change .....	N/A
Outstandings .....	N/A
Other:	
Net change .....	N/A
Outstandings .....	N/A
<b>BORROWING</b>	
Federal National Mortgage Association: <sup>2</sup>	
Portfolio programs:	
Net change .....	N/A
Outstandings .....	N/A
Mortgage-backed securities:	
Net change .....	N/A
Outstandings .....	N/A
Federal Home Loan Mortgage Corporation: <sup>3</sup>	
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 .....	4,381
Outstandings .....	32,847
Farm credit banks:	
Net change .....	13,015
Outstandings .....	94,376
Federal Agricultural Mortgage Corporation:	
Net change .....	623
Outstandings .....	4,554
Federal Home Loan Banks: <sup>4</sup>	
Net change .....	39,094
Outstandings .....	944,039

**Table 7-9. LENDING AND BORROWING BY GOVERNMENT-SPONSORED ENTERPRISES (GSEs) <sup>1</sup>—Continued**

(In millions of dollars)

Enterprise	2006
<b>DEDUCTIONS <sup>5</sup></b>	
Less borrowing from other GSEs: <sup>5</sup>	
Net change .....	N/A
Outstandings .....	N/A
Less purchase of Federal debt securities: <sup>5</sup>	
Net change .....	N/A
Outstandings .....	N/A
Federal National Mortgage Association: <sup>5</sup>	
Net change .....	N/A
Outstandings .....	N/A
Other: <sup>5</sup>	
Net change .....	N/A
Outstandings .....	N/A

N/A = Not available.

<sup>1</sup> 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.

<sup>2</sup> Financial data for Fannie Mae is not presented here because following a restatement of financial data for 2001-2004, audited financial results for 2006 have not been released.

<sup>3</sup> Financial data for Freddie Mac is not presented here because following the release of previous earnings restatements, audited financial statements for 2006 have not been released.

<sup>4</sup> The net change in borrowings is derived from the difference in borrowings between 2006 and the Federal Home Loan Banks' audited financial statements of 2005.

<sup>5</sup> Totals and subtotals have not been calculated because a substantial portion of the total is unavailable as described above.



## 8. AID TO STATE AND LOCAL GOVERNMENTS <sup>1</sup>

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 \$434.1 billion in 2006 and are estimated to be \$448.8 billion in 2007 and \$454.0 billion in 2008.

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 2008; grant outlays for physical capital investment, 16 percent; and grant outlays for all other purposes, largely education, training, and social services, 19 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 bonds from Federal taxation comprise the two largest categories of tax expenditures benefiting State and local governments. In 2008, these provisions are estimated to be worth \$80.1 billion. 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. Tax expenditures that especially aid State and local governments are displayed separately at the end of Tables 19-1 and 19-2.

### 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. In addition to the proposals relating to specific grant programs discussed below, 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 through reducing improper payments and assessing performance of grants with the

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	2006 Actual	2007 Estimate	2008 Proposed
Department of Agriculture .....	25.9	27.0	27.0
Department of Commerce .....	0.5	0.5	0.4
Department of Education .....	41.2	41.8	38.8
Department of Energy .....	0.3	0.2	0.2
Department of Health and Human Services .....	245.0	257.5	265.5
Department of Homeland Security .....	15.3	10.1	7.7
Department of Housing and Urban Development .....	33.2	36.2	37.3
Department of the Interior .....	4.4	4.3	4.3
Department of Justice .....	4.3	3.7	3.1
Department of Labor .....	8.6	8.8	8.5
Department of Transportation .....	46.7	49.6	52.5
Department of the Treasury .....	0.5	0.5	0.6
Department of Veterans Affairs .....	0.6	0.6	0.7
Environmental Protection Agency .....	4.0	3.7	3.5
Other agencies .....	3.7	4.2	3.9
<b>Total .....</b>	<b>434.1</b>	<b>448.8</b>	<b>454.0</b>

Table 8-1 shows the distribution of grants by agency. Grant outlays by the Department of Health and Human Services are estimated to be \$265.5 billion in 2008, almost 60 percent of total grant outlays. Most of the remaining grant spending is in the Departments of Agriculture, Education, Housing and Urban Development, and Transportation, which account for another 34 percent of grant outlays.

Program Assessment Rating Tool (PART), as discussed in a later section of this chapter.

Highlights of proposals affecting grants to State and local governments are presented below. For additional information on these proposals, see discussions in the main *Budget* volume.

#### Homeland Security

Since 2001, this Administration has provided nearly \$37.5 billion to State, local, and tribal government's to enhance first responder preparedness. Of this

<sup>1</sup> 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 two forms of aid are grants and tax expenditures, and grants include both outright grants and the value of loan subsidies.

amount, \$22 billion was allocated through Department of Homeland Security (DHS) grant programs.

To improve coordination and provide assistance to State and local law enforcement officials, the Budget will expand a successful Federal/State and local partnership—the 287(g) program, which provides State and local law enforcement officials with guidance and training in immigration law, subject to the direction of the Secretary of Homeland Security. The 2008 Budget includes an increase of \$26 million for the 287(g) program and the Law Enforcement Support Center, including the training of an additional 250 State and local law enforcement officers, providing information technology connections to participating agencies, detention beds for apprehended illegal aliens, and additional personnel to assist State and local law enforcement when they encounter aliens. It also includes an increase of \$29 million to identify criminal aliens in Federal, State, and local prison facilities and remove those aliens from the United States.

### Natural Resources and Environment

Grant outlays for natural resources and environment programs are estimated to be \$5.6 billion in 2008.

Through the Environmental Protection Agency (EPA), the 2008 Budget provides \$842 million in new capitalization for the Drinking Water State Revolving Fund. States use their capitalization grants, along with matching funds, to make loans to localities. The funds “revolve” as States use loan repayments to make new loans. Included in the President’s Budget is a proposal to exempt private activity bonds (PABs) used to finance drinking water and wastewater infrastructure from the overall private activity bond cap. PABs are tax-exempt bonds issued by a State or local government, the proceeds of which are used by another entity for a public purpose. This exemption will ensure all States and communities have access to PABs to help finance their water infrastructure needs. The proposal also will facilitate public-private partnerships and require full-cost pricing for services, helping drinking water and wastewater systems become self-sustaining.

The Tax Relief and Health Care Act, passed by Congress in December 2006, converted abandoned mine land (AML) reclamation grants to States from discretionary to mandatory funding. Uncertified States (those with high-priority reclamation work) will receive mandatory AML grants from the Abandoned Mine Reclamation Fund to continue their projects. Certified States (those that have already addressed high-priority reclamation work) will no longer be eligible for AML grants. The Act also created a new set of mandatory payments from the Treasury to States in amounts equivalent to the amount allocated to States from coal fees in the AML Trust Fund under the existing AML grant formula.

### Transportation

Grants support State and local programs for highways, mass transit, and airports. Grant outlays to State

and local governments for transportation, mostly for highways, are estimated to be \$52.5 billion in 2008.

This Budget requests \$100 million to issue capital matching grants to States for intercity passenger rail projects. This new program would give local communities resources to direct investment in facilities that reflect their top rail transportation priorities.

### Community and Regional Development

Grant outlays for community and regional development programs are estimated to be \$16.5 billion in 2008.

This Budget provides over \$3 billion for the Community Development Block Grant Program (CDBG) and advances a reform agenda that will distribute resources more equitably and promote efficiency. The current CDBG formula allocates a disproportionate amount of resources to areas with relatively few critical development needs while other, needier areas go underserved. Additionally, HUD continues to work with State and local authorities in the stewardship of \$16.7 billion in supplemental Community Development Block Grant (CDBG) disaster funds to assist in the long-term recovery and rebuilding of the Gulf Coast.

### Education

Grant outlays for elementary, secondary, and vocational education is estimated to be \$35.4 billion in 2008.

**Leaving No Child Behind.** The central goal of the 2001 No Child Left Behind Act (NCLB) is for all students to read and do math at grade level or above by 2014. NCLB refocused Federal education programs on the principles of stronger accountability for results, more choices for parents and students, greater flexibility for States and school districts, and the use of proven instructional methods. In 2007 the President will work with Congress to reauthorize NCLB. Highlights of the President’s plan include the following:

- *Reforming high schools and improving college readiness.* For 2008, this Budget provides \$13.8 billion for Title I, a \$1.1 billion increase, sufficient to devote new funds to high schools, in proportion to the number of low-income students they educate, while also increasing funding for elementary schools. In addition, the Administration proposes to add two new high school tests, including an assessment of college readiness. Together with the existing tests in reading and math in grades 3–8, these assessments will help parents and teachers know how their schools are performing across the K-12 spectrum. The Budget provides \$412 million for these State assessments.
- *Ensuring future competitiveness.* To remain competitive in the global economy, every high school graduate needs strong analytical skills from a rigorous mathematics and science curriculum. In support of this objective, this Budget provides a \$365 million increase for math and science education programs as part of the American Competitiveness Initiative (ACI).

- *Helping schools in need of improvement.* The 2008 Budget provides \$500 million, along with over \$500 million reserved from Title I, to help improve schools that have not met their NCLB goals for at least two years, with a particular focus on schools that have been low-performing for five years or more. This significant increase will ensure that States and school districts have the capacity to turn around the schools that need the most help.
- *Enhancing opportunities for parental choice.* While the Administration expects most schools in need of improvement to turn around and meet the goals of NCLB, some schools will not be able to do so quickly. The 2008 Budget includes a new \$300 million program, Scholarships for Students in Restructuring Schools, which will enable States to offer low-income students in these chronically low-performing schools educational alternatives. These students will be eligible for scholarships to cover some of the cost of attending the private school of their choice or a public school in a neighboring district or receive intensive supplemental services, such as tutoring.

### Training and Employment

Grant outlays for training and employment are estimated to be \$5.5 billion in 2008.

The 2008 Budget again proposes job training reforms in the Department of Labor that will give States more flexibility to deliver workforce services tailored to their unique needs and focus resources on training workers instead of supporting bureaucracy. The reforms will consolidate several similar programs, cut Federal red tape, limit amounts spent on overhead, and create Career Advancement Accounts (CAAs). CAAs are worker-directed accounts that give workers the resources necessary to increase their skills and better compete for 21st Century jobs. The President's job training reform proposal will triple the number of workers receiving training while saving taxpayer dollars.

Over the last several years the Administration has worked to make the Nation's workforce investment system more responsive to the needs of workers and employers. The 2008 Budget continues these initiatives. The President's Budget requests \$150 million for the Community-Based Job Training Grants program, which helps community colleges and related organizations expand their capacity to train workers for jobs that are in demand in local economies. Since 2005 the program has provided grants of almost \$250 million—funds that will be used to train an estimated 100,000 workers. The High Growth Job Training Grants Initiative provides funds to partnerships of training providers, employers, and the public workforce investment system who commit to training workers for jobs in high growth industries. Since its inception the program has trained approximately 51,000 workers, and a total of 128,000 are expected to be trained by 2008.

### Social Services

Grant outlays for social service programs are estimated to be \$14.4 billion in 2008.

**Head Start.** In the Department of Health and Human Services (HHS), the Budget supports reauthorization of Head Start and provides \$6.8 billion in budget authority for 2008, enough to serve more than 900,000 children.

**Child Welfare Program Option.** The 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

Grant outlays for health-related programs are estimated to be \$219.0 billion in 2008.

**Medicaid and the State Children's Health Insurance Program (SCHIP).** In 2008, Department of Health and Human Service's (HHS) Federal Medicaid outlays are estimated to be \$201.9 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 low-income children, pregnant women, elderly persons, and disabled individuals during the year.

SCHIP was established in 1997 to provide \$40 billion over 10 years to States for health care coverage to low-income, uninsured children whose income levels were higher than Medicaid eligibility levels. The authorization for SCHIP expires at the end of 2007.

- *SCHIP.* The 2008 Budget proposes reauthorizing SCHIP for five years. The goal is to maintain current enrollment levels for targeted low-income children over the next few years through increasing the SCHIP allotments by approximately \$5 billion over five years. The 2008 Budget proposes to re-focus SCHIP on low-income, uninsured children below 200 percent of the Federal poverty level as the program was originally intended. The Budget will also seek the authority to target SCHIP funds more efficiently to States with the most need.
- *Transitional Medical Assistance.* This program provides coverage for former welfare recipients entering the workforce, and the Administration proposes extending the provision through 2008.
- *Qualified Individuals.* The 2008 Budget proposes an extension of the Qualified Individuals (QI) provision, which reimburses States for Part B premiums at 100 percent. Under current law, States receive 100 percent Federal funding to pay Medicare Part B premiums for beneficiaries between 120 and 135 percent of the Federal Poverty Level. This program's authorization expires at the end of 2007.

- *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.

*Expanding Access to Recovery (ATR)*. The 2008 Budget includes \$98 million for 20 grants to States and Native American Tribes to provide services to more than 55,000 individuals annually. ATR expands access to treatment and recovery support services, increases clinical treatment and recovery support providers, and enhances accountability through mandatory reporting on outcome measures.

### **Income Support**

Grant outlays for income security programs are estimated to be \$92.5 billion in 2008.

*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 (WIC) serves the nutritional needs of low-income pregnant and post partum women, infants and children up to their fifth birthday. This Budget provides \$5.4 billion for WIC services, which is funding for the estimated 8 million eligible beneficiaries. To address the rising the costs of WIC administration, the 2008 Budget proposes to cap nutrition services and administration funding at 2006 levels. In keeping with the Administration's promotion of childhood wellness and fitness, the department is issuing updated WIC food packages that reduce maximum allowances of certain foods and increase the intake of fresh fruits and vegetables.

*Housing Assistance*. Grant outlays for housing assistance are estimated to be \$29.0 billion in 2008.

*Ending Chronic Homelessness*. The 2008 Budget continues the Administration's commitment to end chronic homelessness by creating new supportive housing options for these individuals. The approximately 150,000 chronically homeless persons identified as the target of this effort include those who have been on the street for long periods and have an addiction and/or suffer from a disabling physical or mental condition. Across the country, local leaders have embraced this goal with over 225 jurisdictions committing to 10-year plans to end chronic homelessness. A number of the jurisdictions that have implemented their plans—including New York, Minneapolis and Columbus—are seeing steady decreases in the number of chronic homeless individuals on their streets and in shelters. This Budget proposes a \$50 million increase, to \$1.6 billion, for Housing and Urban Development's (HUD) Homeless Assistance Grants, which received an Effective rating in last year's Program Assessment Rating Tool (PART) assessment due to its capable program design and strong performance measures. Up to \$50 million will be available for the Samaritan Initiative within the Homeless Assistance Grants annual competition, to provide the chronically homeless with housing assistance coupled with case management to access other essential services.

### **Administration of Justice**

Grant outlays for the administration of justice programs are estimated to be \$3.8 billion in 2008.

The 2008 Budget includes \$1.2 billion in assistance to State and local partners. The Budget proposes to create a new Violent Crime Reduction Partnership Initiative to target resources to those communities with the greatest crime problems. This Budget also proposes to consolidate numerous small grant programs to better target resources to the Nation's most critical needs and increase the efficiency and effectiveness of the grant programs.

The 2008 Budget also provides \$345 million in funding for criminal justice needs, including drug-related priorities, through the new, consolidated Byrne Public Safety and Protection Grants. In addition to funding other law enforcement priorities, the Byrne grants will provide competitive funding to States and localities that can be used to establish Drug Courts and Prescription Drug Monitoring Programs, as well as provide assistance with cannabis eradication and cleanup of toxic methamphetamine labs, and the successful re-entry of prisoners into communities.

## **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 fifth year of using the PART, the Administration has evaluated about 96 percent of the Budget.

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, 257 of the programs that have been assessed are primarily grants to State and local governments. Of these 257, 94 programs, or 47 percent of all grant programs assessed, received a rating of “Results Not Demonstrated”. This is higher than for all programs, in which 34 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 257 grant programs was “adequate.”

- Thirteen were rated effective;
- Sixty-one were rated moderately effective;
- Seventy-four were rated adequate; and
- Fifteen were rated ineffective.

• Ninety-four were rated “results not demonstrated;” If the 94 programs rated “Results Not Demonstrated” are excluded, the average rating was “adequate;” the same as the rating for all 257 grants.

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

Component	Average Scores	
	All grant programs (257 programs)	Programs excluding grants rated “results not demonstrated” (163 programs)
Purpose .....	84%	87%
Planning .....	64%	79%
Management .....	77%	82%
Results/Accountability .....	34%	47%
Average rating <sup>1</sup> .....	Adequate	Adequate

Rating <sup>1</sup>	Number of grant programs
Effective .....	13
Moderately effective .....	61
Adequate .....	74
Ineffective .....	15
Results not demonstrated .....	94
Total number of grant programs rated .....	257

<sup>1</sup> 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.

The ratings of the largest five of these 257 grant programs are summarized here. More complete summaries of these and other programs can be found at [www.ExpectMore.gov](http://www.ExpectMore.gov).

- *Department of Transportation: Highway Infrastructure (\$34.2 billion in 2006). 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 Health and Human Services: Temporary Assistance for Needy Families (TANF) (\$17.1 billion in 2006). Rating: Moderately Effective.*

tive. This program provides time-limited cash assistance to needy families with children while working toward achieving the goals of ending dependence by promoting work and marriage, prevent out-of-wedlock births, and encouraging the formation and maintenance of two-parent families. The program has produced modest, but statistically significant increases in employment and earnings among welfare recipients as well as reduced caseloads, poverty, and welfare dependency. It is inconclusive whether the program has promoted marriage or reduced the incidence of out-of-wedlock births. The program does not require States to report or demonstrate progress on promoting marriage.

- *Department of Housing and Urban Development (HUD): Housing Vouchers (\$14.1 billion in 2006). Rating: Moderately Effective.* The Housing Choice Voucher Program assists two million low-income households across the country to afford housing. The program purpose is to help these families afford decent, safe and sanitary housing. Tenants, who would otherwise pay over 50% of their income to rent an apartment on the private market, pay 30% of their income under this program. 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 programs for housing assistance 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: Title I Grants to Local Educational Agencies (\$12.7 billion for 2006). Rating: Moderately Effective.* This program provides supplemental education funding, especially in high-poverty areas, for local activities that help improve the performance of low-achieving students or, in the case of school-wide programs, to help all students in high-poverty schools to meet challenging State academic standards. The program has developed meaningful long-term performance measures, established baselines, and set annual targets required to meet ambitious statutory academic proficiency goals. First-year data show a rate of progress consistent with meeting annual performance targets. The Department of Education has expanded and strengthened its monitoring of State and local program implementation, including compliance with statutory requirements and fiscal management practices.

- *Department of Education: IDEA Special Education Grants to States (\$10.6 billion for 2006). Rating: Adequate.* The 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. The percentage of students with disabilities who graduate from high school with a regular high school diploma increased from 46% in 2000 to 54% in 2004 and the percentage who drop out of school decreased from 42% in 2000 to 31% in 2004. 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.

**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 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, 15 percent of block grant programs assessed to date were rated ineffective, and 37 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.

The 2008 Budget also enhances accountability and improves performance outcomes by encouraging the Community Mental Health Services and Substance

Abuse, Prevention, and Treatment Block Grant Programs to report on established National Outcome Measures.

### 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 in-

come 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	2008
<b>A. Distribution of grants by function:</b>													
Natural resources and environment .....	0.1	0.2	0.4	2.4	5.4	4.1	3.7	4.0	4.6	5.9	6.1	5.9	5.6
Agriculture .....	0.2	0.5	0.6	0.4	0.6	2.4	1.3	0.8	0.7	0.9	0.7	0.8	0.8
Transportation .....	3.0	4.1	4.6	5.9	13.0	17.0	19.2	25.8	32.2	43.4	46.7	49.6	52.5
Community and regional development .....	0.1	0.6	1.8	2.8	6.5	5.2	5.0	7.2	8.7	20.2	21.3	18.9	16.5
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	60.5	61.6	56.7
Health .....	0.2	0.6	3.8	8.8	15.8	24.5	43.9	93.6	124.8	197.8	197.3	208.9	219.0
Income security .....	2.6	3.5	5.8	9.4	18.5	27.9	36.8	58.4	68.7	90.9	89.8	91.8	92.5
Administration of Justice .....	*	*	*	0.7	0.5	0.1	0.6	1.2	5.3	4.8	5.0	4.3	3.8
General government .....	0.2	0.2	0.5	7.1	8.6	6.8	2.3	2.3	2.1	4.4	3.9	3.7	3.5
Other .....	*	0.1	0.1	0.2	0.7	0.8	0.8	0.8	2.1	2.6	2.8	3.3	3.1
<b>Total .....</b>	<b>7.0</b>	<b>10.9</b>	<b>24.1</b>	<b>49.8</b>	<b>91.4</b>	<b>105.9</b>	<b>135.3</b>	<b>225.0</b>	<b>285.9</b>	<b>428.0</b>	<b>434.1</b>	<b>448.8</b>	<b>454.0</b>
<b>B. Distribution of grants by BEA category:</b>													
Discretionary .....	N/A	2.9	10.2	21.0	53.3	55.5	63.3	94.0	116.7	181.7	186.1	185.8	182.2
Mandatory .....	N/A	8.0	13.9	28.8	38.1	50.4	72.0	131.0	169.2	246.3	248.0	263.0	271.8
<b>Total .....</b>	<b>7.0</b>	<b>10.9</b>	<b>24.1</b>	<b>49.8</b>	<b>91.4</b>	<b>105.9</b>	<b>135.3</b>	<b>225.0</b>	<b>285.9</b>	<b>428.0</b>	<b>434.1</b>	<b>448.8</b>	<b>454.0</b>
<b>C. Composition:</b>													
Payments for individuals <sup>1</sup> .....	2.5	3.7	8.7	16.8	32.6	50.1	77.3	144.4	182.6	273.9	272.6	285.2	296.7
Physical capital <sup>1</sup> .....	3.3	5.0	7.1	10.9	22.6	24.9	27.2	39.6	48.7	60.8	64.1	69.2	71.8
Other grants .....	1.2	2.2	8.3	22.2	36.2	30.9	30.9	41.0	54.6	93.3	97.4	94.4	85.4
<b>Total .....</b>	<b>7.0</b>	<b>10.9</b>	<b>24.1</b>	<b>49.8</b>	<b>91.4</b>	<b>105.9</b>	<b>135.3</b>	<b>225.0</b>	<b>285.9</b>	<b>428.0</b>	<b>434.1</b>	<b>448.8</b>	<b>454.0</b>
<b>D. Total grants as a percent of:</b>													
<b>Federal outlays:</b>													
Total .....	7.6%	9.2%	12.3%	15.0%	15.5%	11.2%	10.8%	14.8%	16.0%	17.3%	16.3%	16.1%	15.6%
Domestic programs <sup>2</sup> .....	18.0%	18.3%	23.2%	21.7%	22.2%	18.2%	17.1%	21.6%	22.0%	23.4%	22.4%	22.2%	21.8%
State and local expenditures .....	14.8%	15.5%	20.1%	24.0%	27.4%	22.0%	18.9%	22.8%	22.2%	24.3%	23.3%	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%	3.3%	3.3%	3.1%
<b>E. As a share of total State and local gross investments:</b>													
Federal capital grants .....	24.6%	25.5%	25.4%	26.0%	35.4%	30.2%	21.9%	26.0%	21.9%	21.5%	20.9%	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%	78.5%	79.1%	N/A	N/A
<b>Total .....</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>N/A</b>	<b>N/A</b>

N/A: Not available.

\*50 million or less.

<sup>1</sup> Grants that are both payments for individuals and capital investment are shown under capital investment.

<sup>2</sup> 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 \$394.4 billion, or more than 90 percent of total grant outlays in 2006.

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 \$197.3 billion in 2006. 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 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 \$248.0 billion in 2006. The three largest mandatory grant programs are Medicaid, with outlays of \$180.6 billion in 2006, Temporary Assistance for Needy Families, \$16.9 billion, and child nutrition programs, \$12.3 billion.

The funding level for discretionary grant programs is determined annually through appropriations acts. Outlays for discretionary grant programs were \$186.1 billion in 2006. 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.<sup>2</sup> 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 about a third of the total in 1960 to slightly less than two-thirds in the mid-1990s, and have remained about that proportion since then.

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, 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 2006, grants for physical capital were \$64.1 billion, 15 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 2006.

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 16 percent in 2006. Grants as a percentage of domestic programs were 22 percent in 2006. As a percentage of total State and local expenditures, grants have increased from 19 percent in 1990 to 23 percent in 2006.

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 2006.

## 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 govern-

ments 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

<sup>2</sup> 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.



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 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 on-line database (*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 *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, in-

cluding 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		
	2006 Actual	2007 Estimate	2008 Estimate	2006 Actual	2007 Estimate	2008 Estimate
<b>NATIONAL DEFENSE</b>						
<b>Discretionary:</b>						
Department of Defense—Military:						
Research, development, test, and evaluation, Army .....	2	2	2	2	2	2
<b>ENERGY</b>						
<b>Discretionary:</b>						
Department of Energy:						
Energy Programs:						
Energy conservation .....				150		
Energy supply and conservation .....	279	213	179	125	215	200
<b>Total, discretionary</b> .....	<b>279</b>	<b>213</b>	<b>179</b>	<b>275</b>	<b>215</b>	<b>200</b>
<b>Mandatory:</b>						
Tennessee Valley Authority fund .....	376	439	449	376	439	449
<b>Total, energy</b> .....	<b>655</b>	<b>652</b>	<b>628</b>	<b>651</b>	<b>654</b>	<b>649</b>
<b>NATURAL RESOURCES AND ENVIRONMENT</b>						
<b>Discretionary:</b>						
Department of Agriculture:						
Farm Service Agency:						
Grassroots source water protection program .....	4	4		4	4	
Natural Resources Conservation Service:						
Watershed rehabilitation program .....	5	5		2	2	2
Resource conservation and development .....				1	1	1
Watershed and flood prevention operations .....	164	15		133	141	81
Forest Service:						
State and private forestry .....	303	216	183	339	326	290
Management of national forest lands for subsistence uses .....	5	5	5	5	7	5
Department of Commerce:						
National Oceanic and Atmospheric Administration:						
Operations, research, and facilities .....	91	77	93	35	31	40
Pacific coastal salmon recovery .....	67	20	67	80	65	67
Procurement, acquisition and construction .....	89	1	16	61	1	11
Department of the Interior:						
Office of Surface Mining Reclamation and Enforcement:						
Regulation and technology .....	59	59	62	58	59	60
Abandoned mine reclamation fund .....	167	163	33	186	157	156
United States Fish and Wildlife Service:						
State and tribal wildlife grants .....	67	50	69	74	66	81
Cooperative endangered species conservation fund .....	80	80	80	38	80	80
Landowner incentive program .....	22	15		14	21	22
National Park Service:						
Urban park and recreation fund .....				14	9	3
National recreation and preservation .....	54	47	49	59	52	50
Land acquisition and State assistance .....	30	2		107	83	60
Historic preservation fund .....	115	59	64	66	77	79
Environmental Protection Agency:						
State and tribal assistance grants .....	3,141	3,009	2,739	3,874	3,634	3,381
Hazardous substance superfund .....	45	33	29	38	25	25
Leaking underground storage tank trust fund .....	70	56	60	54	53	54
<b>Total, discretionary</b> .....	<b>4,578</b>	<b>3,916</b>	<b>3,549</b>	<b>5,242</b>	<b>4,894</b>	<b>4,548</b>
<b>Mandatory:</b>						
Department of the Interior:						
Bureau of Land Management:						
Miscellaneous permanent payment accounts .....	139	40	49	138	46	49
Minerals Management Service:						
National forests fund, Payment to States .....	9	6	7	9	6	8
Leases of lands acquired for flood control, navigation, and allied purposes .....	5	3	3	5	3	3
Coastal impact assistance .....		250	250		250	250
Office of Surface Mining Reclamation and Enforcement:						
Abandoned mine reclamation fund .....			94			25

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		
	2006 Actual	2007 Estimate	2008 Estimate	2006 Actual	2007 Estimate	2008 Estimate
Bureau of Reclamation:						
Bureau of Reclamation loan subsidy .....	2	4		2	4	
United States Fish and Wildlife Service:						
Federal aid in wildlife restoration .....	265	293	300	257	251	264
Cooperative endangered species conservation fund .....	39	46	48	39	46	48
Sport fish restoration .....	364	432	452	365	376	410
Department of the Treasury:						
Financial Management Service:						
Payment to terrestrial wildlife habitat restoration trust fund .....	5	5	5	5	5	5
<b>Total, mandatory .....</b>	<b>828</b>	<b>1,079</b>	<b>1,208</b>	<b>820</b>	<b>987</b>	<b>1,062</b>
<b>Total, natural resources and environment .....</b>	<b>5,406</b>	<b>4,995</b>	<b>4,757</b>	<b>6,062</b>	<b>5,881</b>	<b>5,610</b>
<b>AGRICULTURE</b>						
<b>Discretionary:</b>						
Department of Agriculture:						
Cooperative State Research, Education, and Extension Service:						
Extension activities .....	456	456	436	423	443	496
Outreach for socially disadvantaged farmers .....	6	6	7	6	6	7
Research and education activities .....	241	249	223	241	256	249
Integrated activities .....	25	25	5	23	27	26
Agricultural Marketing Service:						
Payments to States and possessions .....	11	1	1	5	1	1
Farm Service Agency:						
State mediation grants .....	4	4	4	4	4	5
<b>Total, discretionary .....</b>	<b>743</b>	<b>741</b>	<b>676</b>	<b>702</b>	<b>737</b>	<b>784</b>
<b>Mandatory:</b>						
Department of Agriculture:						
Office of the Secretary:						
Fund for rural America .....				1		
Farm Service Agency:						
Commodity Credit Corporation fund .....	46	41	40	46	41	40
<b>Total, mandatory .....</b>	<b>46</b>	<b>41</b>	<b>40</b>	<b>47</b>	<b>41</b>	<b>40</b>
<b>Total, agriculture .....</b>	<b>789</b>	<b>782</b>	<b>716</b>	<b>749</b>	<b>778</b>	<b>824</b>
<b>COMMERCE AND HOUSING CREDIT</b>						
<b>Mandatory:</b>						
Department of Commerce:						
National Oceanic and Atmospheric Administration:						
Promote and develop fishery products and research pertaining to American fisheries ..	12	6	6	12	9	6
Federal Communications Commission:						
Universal service fund .....	1,462	1,977	1,760	1,462	1,977	1,760
<b>Total, commerce and housing credit .....</b>	<b>1,474</b>	<b>1,983</b>	<b>1,766</b>	<b>1,474</b>	<b>1,986</b>	<b>1,766</b>
<b>TRANSPORTATION</b>						
<b>Discretionary:</b>						
Department of Transportation:						
Federal Aviation Administration:						
Grants-in-aid for airports (Airport and airway trust fund) .....				3,841	3,821	3,711
Federal Highway Administration:						
Emergency relief program .....	3,452			849	1,438	586
State infrastructure banks .....				1	1	1
Appalachian development highway system .....	20	82		95	139	127
Federal-aid highways .....				32,703	33,083	36,857
Miscellaneous appropriations .....			-149	187	116	41
Miscellaneous highway trust funds .....			-260	145	140	11
Federal Motor Carrier Safety Administration:						
Motor Carrier Safety Grants .....	279	291	300	74	271	284
National Highway Traffic Safety Administration:						
Highway traffic safety grants .....	558	566	581	263	534	580

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		
	2006 Actual	2007 Estimate	2008 Estimate	2006 Actual	2007 Estimate	2008 Estimate
Federal Railroad Administration:						
Alaska railroad rehabilitation .....	10	10		20	11	6
Federal Transit Administration:						
Job access and reverse commute grants .....				95	103	65
Interstate transfer grants-transit .....				-19	2	2
Washington Metropolitan Area Transit Authority .....				4	2	1
Formula grants .....	144			3,376	2,464	1,504
Capital investment grants .....	1,487	1,548	1,400	3,073	3,350	2,905
Discretionary grants (Highway trust fund, mass transit account) .....				92	53	40
Formula and bus grants .....	8,281	7,190	7,873	1,863	4,074	5,759
Pipeline and Hazardous Materials Safety Administration:						
Pipeline safety .....	19	20	24	19	23	24
United States-Canada Alaska Rail Commission:						
Contribution to United States-Canada Alaska Rail Commission .....				2		
<b>Total, discretionary .....</b>	<b>14,250</b>	<b>9,707</b>	<b>9,769</b>	<b>46,683</b>	<b>49,625</b>	<b>52,504</b>
<b>Mandatory:</b>						
Department of Transportation:						
Federal Aviation Administration:						
Grants-in-aid for airports (Airport and airway trust fund) .....	3,070	4,267	2,750			
Federal Highway Administration:						
Federal-aid highways .....	32,916	37,498	40,381			
<b>Total, mandatory .....</b>	<b>35,986</b>	<b>41,765</b>	<b>43,131</b>			
<b>Total, transportation .....</b>	<b>50,236</b>	<b>51,472</b>	<b>52,900</b>	<b>46,683</b>	<b>49,625</b>	<b>52,504</b>
<b>COMMUNITY AND REGIONAL DEVELOPMENT</b>						
<b>Discretionary:</b>						
Department of Agriculture:						
Rural Development:						
Rural community advancement program .....	735	553		773	726	
Rural Utilities Service:						
Distance learning, telemedicine, and broadband program .....	16	16	16	14	13	15
Rural water and waste disposal subsidy .....			502			485
Rural Housing Service:						
Rural community facility subsidy .....			22			74
Rural Business—Cooperative Service:						
Rural business and industry subsidy .....			38			71
Department of Commerce:						
Economic development assistance programs .....	250	231	170	284	314	295
Department of Homeland Security:						
Federal Emergency Management Agency:						
State and local programs .....	2,318	2,367	1,633	2,601	1,956	2,128
Firefighter assistance grants .....	648	662	300	228	565	639
Mitigation grants .....				34	98	
Disaster Relief .....	-17,423	2,909	1,409	11,868	6,895	4,302
Department of Housing and Urban Development:						
Community Planning and Development:						
Community development fund .....	20,851	4,215	2,681	5,012	7,828	7,999
Urban development action grants .....					2	2
Community development loan guarantees subsidy .....	4	3		8	8	5
Brownfields redevelopment .....				18	22	28
Empowerment zones/enterprise communities/renewal communities .....				39	35	30
Office of Lead Hazard Control and Healthy Homes:						
Lead hazard reduction .....	150	150	116	120	141	154
Department of the Interior:						
Bureau of Indian Affairs and Bureau of Indian Education:						
Operation of Indian programs .....	149	150	150	148	146	147
Indian guaranteed loan subsidy .....	26	20	6	24	20	6
Appalachian Regional Commission .....	56	27	57	63	65	66
Delta regional authority .....	12	5	4	6	5	7
Denali Commission .....	49	8	2	42	44	70

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		
	2006 Actual	2007 Estimate	2008 Estimate	2006 Actual	2007 Estimate	2008 Estimate
<b>Total, discretionary</b> .....	<b>7,841</b>	<b>11,316</b>	<b>7,106</b>	<b>21,282</b>	<b>18,883</b>	<b>16,523</b>
<b>Mandatory:</b>						
Department of Housing and Urban Development:						
Community Planning and Development:						
Community development loan guarantees subsidy .....	3	8		3	8	
<b>Total, community and regional development</b> .....	<b>7,844</b>	<b>11,324</b>	<b>7,106</b>	<b>21,285</b>	<b>18,891</b>	<b>16,523</b>
<b>EDUCATION, TRAINING, EMPLOYMENT, AND SOCIAL SERVICES</b>						
<b>Discretionary:</b>						
Department of Commerce:						
National Telecommunications and Information Administration:						
Public telecommunications facilities, planning and construction .....	22	20		24	33	25
Information infrastructure grants .....				11	7	4
Department of Education:						
Office of Elementary and Secondary Education:						
Reading excellence .....				1	6	
Indian education .....	115	115	115	114	116	113
Impact aid .....	1,224	1,253	1,224	1,138	1,456	1,224
Education reform .....				15	4	
Education for the disadvantaged .....	14,434	14,434	16,641	14,604	14,716	14,478
School improvement programs .....	5,110	5,120	4,635	5,589	5,439	5,107
Office of Innovation and Improvement:						
Innovation and improvement .....	643	549	778	451	893	625
Office of Safe and Drug-Free Schools:						
Safe schools and citizenship education .....	688	685	290	717	730	685
Office of English Language Acquisition:						
English language acquisition .....	629	631	631	551	795	585
Office of Special Education and Rehabilitative Services:						
Special education .....	11,439	11,346	10,505	11,582	11,267	10,581
Rehabilitation services and disability research .....	127	127	56	140	172	80
American Printing House for the Blind .....	18	18	18	19	20	18
Office of Vocational and Adult Education:						
Career, technical and adult education .....	1,972	1,970	1,960	1,958	2,034	1,910
Office of Postsecondary Education:						
Higher education .....	403	403	302	439	478	424
Office of Federal Student Aid:						
Student financial assistance .....	65	64		68	71	51
Institute of education sciences .....	25	49	49	4	38	39
Hurricane education recovery .....	1,885			1,140	743	
Department of Health and Human Services:						
Administration for Children and Families:						
Promoting safe and stable families .....	82	82	82	82	82	82
Children and families services programs .....	8,560	8,507	7,869	8,492	8,466	8,104
Administration on Aging:						
Aging services programs .....	1,345	1,349	1,318	1,358	1,327	1,323
Department of the Interior:						
Bureau of Indian Affairs and Bureau of Indian Education:						
Operation of Indian programs .....	116	116	116	114	111	112
Department of Labor:						
Employment and Training Administration:						
Training and employment services .....	4,706	4,897	4,543	4,566	4,489	4,283
Community service employment for older Americans .....	94	94	76	88	94	76
State unemployment insurance and employment service operations .....	124	120	17	155	123	130
Unemployment trust fund .....	726	952	256	803	1,055	797
Corporation for National and Community Service:						
Domestic volunteer service programs, operating expenses .....	105	105		142	133	79
National and community service programs, operating expenses .....	265	265	255	255	224	200
Corporation for Public Broadcasting .....	460	464	350	460	464	350
District of Columbia:						
District of Columbia General and Special Payments:						
Federal payment for resident tuition support .....	33	33	35	33	33	35
Federal payment for school improvement .....	40	40	41	40	40	41
National Endowment for the Arts: grants and administration .....	41	40	41	37	38	39

**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		
	2006 Actual	2007 Estimate	2008 Estimate	2006 Actual	2007 Estimate	2008 Estimate
Institute of Museum and Library Services:						
Office of Museum and Library Services: grants and administration .....	238	231	254	226	273	282
<b>Total, discretionary</b> .....	<b>55,734</b>	<b>54,079</b>	<b>52,457</b>	<b>55,416</b>	<b>55,970</b>	<b>51,882</b>
<b>Mandatory:</b>						
Department of Education:						
Office of Special Education and Rehabilitative Services:						
Rehabilitation services and disability research .....	2,720	2,837	2,874	2,679	2,848	2,858
Department of Health and Human Services:						
Administration for Children and Families:						
Promoting safe and stable families .....	364	364	364	334	361	357
Social services block grant .....	2,250	1,700	1,200	1,848	2,155	1,306
Department of Labor:						
Employment and Training Administration:						
Federal unemployment benefits and allowances .....	259	260	260	235	260	260
Foreign labor certification processing .....			5			5
<b>Total, mandatory</b> .....	<b>5,593</b>	<b>5,161</b>	<b>4,703</b>	<b>5,096</b>	<b>5,624</b>	<b>4,786</b>
<b>Total, education, training, employment, and social services</b> .....	<b>61,327</b>	<b>59,240</b>	<b>57,160</b>	<b>60,512</b>	<b>61,594</b>	<b>56,668</b>
<b>HEALTH</b>						
<b>Discretionary:</b>						
Department of Agriculture:						
Food Safety and Inspection Service:						
Salaries and expenses .....	43	43	46	38	45	44
Department of Health and Human Services:						
Health Resources and Services Administration .....	3,298	3,302	2,847	3,340	3,183	3,110
Centers for Disease Control and Prevention:						
Disease control, research, and training .....	4,052	3,926	3,926	3,039	3,832	3,969
Substance Abuse and Mental Health Services Administration .....	3,204	2,308	2,196	3,183	2,308	2,294
Departmental Management:						
Public health and social services emergency fund .....	436	242	436	184	158	321
General departmental management .....	102	110	106	109	77	80
Department of Labor:						
Occupational Safety and Health Administration:						
Salaries and expenses .....	101	91	91	101	101	97
Mine Safety and Health Administration:						
Salaries and expenses .....	8	8	8	8	8	8
<b>Total, discretionary</b> .....	<b>11,244</b>	<b>10,030</b>	<b>9,656</b>	<b>10,002</b>	<b>9,712</b>	<b>9,923</b>
<b>Mandatory:</b>						
Department of Health and Human Services:						
Centers for Medicare and Medicaid Services:						
Grants to States for medicaid .....	215,471	168,290	204,944	180,625	191,876	201,944
State children's health insurance fund .....	4,365	5,040	5,040	5,451	5,647	6,644
State grants and demonstrations .....	2,566	707	764	1,269	1,679	496
<b>Total, mandatory</b> .....	<b>222,402</b>	<b>174,037</b>	<b>210,748</b>	<b>187,345</b>	<b>199,202</b>	<b>209,084</b>
<b>Total, health</b> .....	<b>233,646</b>	<b>184,067</b>	<b>220,404</b>	<b>197,347</b>	<b>208,914</b>	<b>219,007</b>
<b>INCOME SECURITY</b>						
<b>Discretionary:</b>						
Department of Agriculture:						
Food and Nutrition Service:						
Commodity assistance program .....	187	177	70	182	180	79
Special supplemental nutrition program for women, infants, and children (WIC) .....	5,172	5,169	5,387	5,056	5,172	5,320
Department of Health and Human Services:						
Administration for Children and Families:						
Low income home energy assistance .....	3,160	2,161	1,782	2,637	2,635	1,874
Refugee and entrant assistance .....	387	370	473	425	421	479
Payments to States for the child care and development block grant .....	2,055	2,056	2,056	2,185	2,017	2,046

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		
	2006 Actual	2007 Estimate	2008 Estimate	2006 Actual	2007 Estimate	2008 Estimate
Department of Homeland Security:						
Federal Emergency Management Agency:						
Emergency food and shelter .....	151	151	140	151	151	140
Department of Housing and Urban Development:						
Public and Indian Housing Programs:						
Public housing operating fund .....	3,564	3,564	4,000	3,496	3,614	3,891
Drug elimination grants for low-income housing .....	-3			1	2	1
Revitalization of severely distressed public housing (HOPE VI) .....	99	183	-99	567	560	535
Native Hawaiian Housing Block Grant .....	9		6		2	3
Tenant based rental assistance .....	14,401	15,081	16,000	12,966	15,321	15,986
Project-based rental assistance .....	205	221	221	210	222	200
Public housing capital fund .....	2,420	2,208	2,024	3,161	3,082	3,075
Prevention of resident displacement .....				71	1	
Native American housing block grant .....	624	624	627	585	584	579
Housing certificate fund .....				2,188		
Community Planning and Development:						
Homeless assistance grants .....	1,327	1,353	1,586	1,346	1,378	1,395
Home investment partnership program .....	1,757	1,805	1,967	1,812	1,870	1,901
Housing opportunities for persons with AIDS .....	286	296	300	309	309	309
Rural housing and economic development .....	17	24		21	22	27
Housing Programs:						
Homeownership and opportunity for people everywhere grants (HOPE grants) .....				1	1	1
Housing for persons with disabilities .....	231	240	125	301	260	259
Housing for the elderly .....	726	747	575	922	875	874
Department of Labor:						
Employment and Training Administration:						
Unemployment trust fund .....	2,514	2,653	2,654	2,668	2,668	2,795
<b>Total, discretionary</b> .....	<b>39,289</b>	<b>39,083</b>	<b>39,894</b>	<b>41,261</b>	<b>41,347</b>	<b>41,769</b>
<b>Mandatory:</b>						
Department of Agriculture:						
Agricultural Marketing Service:						
Funds for strengthening markets, income, and supply (section 32) .....	1,133	1,177	1,087	1,281	1,024	1,087
Food and Nutrition Service:						
Food stamp program .....	4,579	4,636	4,832	4,608	4,638	4,812
Commodity assistance program .....	15	15	15	15	15	15
Child nutrition programs .....	12,534	13,033	13,739	12,263	13,482	13,669
Department of Health and Human Services:						
Administration for Children and Families:						
Payments to States for child support enforcement and family support programs .....	3,322	4,399	3,957	4,001	4,519	4,085
Contingency fund .....				77	103	91
Payments to States for foster care and adoption assistance .....	6,620	6,941	6,892	6,353	6,533	6,834
Child care entitlement to States .....	1,926	2,917	2,917	3,060	2,828	2,800
Temporary assistance for needy families .....	11,988	17,059	17,059	16,897	17,318	17,296
<b>Total, mandatory</b> .....	<b>42,117</b>	<b>50,177</b>	<b>50,498</b>	<b>48,555</b>	<b>50,460</b>	<b>50,689</b>
<b>Total, income security</b> .....	<b>81,406</b>	<b>89,260</b>	<b>90,392</b>	<b>89,816</b>	<b>91,807</b>	<b>92,458</b>
<b>SOCIAL SECURITY</b>						
<b>Mandatory:</b>						
Social Security Administration:						
Federal disability insurance trust fund .....	32	54	60	9	50	57
<b>VETERANS BENEFITS AND SERVICES</b>						
<b>Discretionary:</b>						
Department of Veterans Affairs:						
Veterans Health Administration:						
Medical services .....	466	501	563	466	501	563
Departmental Administration:						
Grants for construction of State extended care facilities .....	85	85	85	122	92	86
Grants for the construction of State veterans cemeteries .....	32	18	32	37	15	21
<b>Total, veterans benefits and services</b> .....	<b>583</b>	<b>604</b>	<b>680</b>	<b>625</b>	<b>608</b>	<b>670</b>

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		
	2006 Actual	2007 Estimate	2008 Estimate	2006 Actual	2007 Estimate	2008 Estimate
<b>ADMINISTRATION OF JUSTICE</b>						
<b>Discretionary:</b>						
Department of Homeland Security:						
Federal Emergency Management Agency:						
State and local programs .....	411	364	263	292	255	334
Department of Housing and Urban Development:						
Fair Housing and Equal Opportunity:						
Fair housing activities .....	46	45	45	47	46	45
Department of Justice:						
Legal Activities and U.S. Marshals:						
Assets forfeiture fund .....	17	17	21	16	15	16
Office of Justice Programs:						
Justice assistance .....	151	87	100	256	139	166
State and local law enforcement assistance .....	1,115	1,042	390	1,711	1,272	1,037
Juvenile justice programs .....	270	263	226	366	403	377
Community oriented policing services .....	385	428	-55	708	634	293
Violence against women prevention and prosecution programs .....	368	401	356	367	297	347
Equal Employment Opportunity Commission:						
Salaries and expenses .....	33	28	28	29	43	42
Federal Drug Control Programs:						
High-intensity drug trafficking areas program .....	200	225	220	172	170	218
State Justice Institute:						
State Justice Institute: salaries and expenses .....	4			5		
<b>Total, discretionary</b> .....	<b>3,000</b>	<b>2,900</b>	<b>1,594</b>	<b>3,969</b>	<b>3,274</b>	<b>2,875</b>
<b>Mandatory:</b>						
Department of Justice:						
Legal Activities and U.S. Marshals:						
Assets forfeiture fund .....	383	282	375	342	377	270
Office of Justice Programs:						
Crime victims fund .....	585	537	589	561	582	570
Department of the Treasury:						
Departmental Offices:						
Treasury forfeiture fund .....	84	80	80	89	80	80
<b>Total, mandatory</b> .....	<b>1,052</b>	<b>899</b>	<b>1,044</b>	<b>992</b>	<b>1,039</b>	<b>920</b>
<b>Total, administration of justice</b> .....	<b>4,052</b>	<b>3,799</b>	<b>2,638</b>	<b>4,961</b>	<b>4,313</b>	<b>3,795</b>
<b>GENERAL GOVERNMENT</b>						
<b>Discretionary:</b>						
Department of Health and Human Services:						
Administration for Children and Families:						
Disabled voter services .....				3	5	2
Department of the Interior:						
United States Fish and Wildlife Service:						
National wildlife refuge fund .....	14	14	11	14	14	13
Insular Affairs:						
Assistance to territories .....	48	47	47	58	53	52
Trust Territory of the Pacific Islands .....						1
Department-Wide Programs:						
Payments in lieu of taxes .....	233	233	190	232	233	190
District of Columbia:						
District of Columbia Courts:						
Federal payment to the District of Columbia courts .....	217	220	214	182	220	214
Defender services in District of Columbia courts .....	45	37	43	37	37	42
District of Columbia General and Special Payments:						
Federal support for economic development and management reforms in the District ...	52	13	38	52	13	38
Election Assistance Commission:						
Election reform programs .....				58		
<b>Total, discretionary</b> .....	<b>609</b>	<b>564</b>	<b>543</b>	<b>636</b>	<b>575</b>	<b>552</b>



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		
	2006 Actual	2007 Estimate	2008 Estimate	2006 Actual	2007 Estimate	2008 Estimate
<b>Mandatory:</b>						
Department of Agriculture:						
Forest Service:						
Forest Service permanent appropriations .....	582	364	130	425	409	130
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 .....	106	111	117	101	142	117
Department of the Interior:						
Bureau of Land Management:						
Miscellaneous permanent payment accounts .....	109	103	4	109	103	9
Minerals Management Service:						
Mineral leasing and associated payments .....	2,113	1,875	1,995	2,113	1,875	1,995
Geothermal lease revenues, payment to counties .....	4	3	.....	4	3	.....
United States Fish and Wildlife Service:						
National wildlife refuge fund .....	12	9	7	12	9	6
Insular Affairs:						
Assistance to territories .....	28	31	28	29	36	34
Payments to the United States territories, fiscal assistance .....	131	119	119	131	119	119
Department of the Treasury:						
Alcohol and Tobacco Tax and Trade Bureau:						
Internal revenue collections for Puerto Rico .....	360	448	484	360	448	484
Corps of Engineers-Civil Works:						
Permanent appropriations .....	.....	4	4	.....	4	4
<b>Total, mandatory .....</b>	<b>3,448</b>	<b>3,070</b>	<b>2,891</b>	<b>3,287</b>	<b>3,151</b>	<b>2,901</b>
<b>Total, general government .....</b>	<b>4,057</b>	<b>3,634</b>	<b>3,434</b>	<b>3,923</b>	<b>3,726</b>	<b>3,453</b>
<b>Total, Grants .....</b>	<b>451,509</b>	<b>411,868</b>	<b>442,643</b>	<b>434,099</b>	<b>448,829</b>	<b>453,986</b>
Discretionary .....	138,152	133,155	126,105	186,095	185,842	182,232
Mandatory .....	313,357	278,713	316,538	248,004	262,987	271,754

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**APPENDIX: SELECTED GRANT DATA BY STATE**

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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 2006 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 2007 obligations by State from previous budget authority, from new budget authority, and total obligations.
- Estimates of 2008 obligations by State, which are also based on the 2008 Budget request, unless otherwise noted.
- The percentage share of 2008 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 2006 (actual)	Estimated FY 2007 obligations from:			FY 2008 (estimated)
		Previous authority	New authority	Total	
<b>Department of Agriculture, Food and Nutrition Service</b>					
School Breakfast Program (10.553) .....	2,086		2,241	2,241	2,390
National School Lunch Program (10.555) .....	7,570	63	7,792	7,855	8,181
Special Supplemental Nutrition Program for Women, Infants, and Children (WIC) (10.557) .....	5,363	295	5,168	5,463	5,477
Child and Adult Care Food Program (10.558) .....	2,141		2,172	2,172	2,289
State Administrative Matching Grants for Food Stamp Program (10.561) .....	2,455		2,551	2,551	2,662
<b>Department of Education, Office of Elementary and Secondary Education</b>					
Title I Grants to Local Educational Agencies (84.010) .....	12,713		12,713	12,713	13,910
Improving Teacher Quality State Grants (84.367) .....	2,887		2,887	2,887	2,787
<b>Department of Education, Office of Special Education and Rehabilitative Services</b>					
Special Education—Grants to States (84.027) .....	10,583		10,492	10,492	10,492
Rehabilitation Services—Vocational Rehabilitation Grants to States (84.126) .....	2,720		2,837	2,837	2,837
<b>Department of Health and Human Services, Centers for Medicare and Medicaid Services</b>					
State Children's Health Insurance Program (93.767) .....	4,365		5,040	5,040	5,040
Grants to States for Medicaid (93.778) .....	201,842		195,191	195,191	206,886
<b>Department of Health and Human Services, Administration for Children and Families</b>					
Temporary Assistance for Needy Families (TANF)—Family Assistance Grants (93.558) .....	17,140		17,059	17,059	17,059
Child Support Enforcement—Federal Share of State and Local Administrative Costs and Incentives (93.563) .....	4,197		4,415	4,415	3,963
Low Income Home Energy Assistance Program (93.568) .....	2,480		1,980	1,980	1,500
Child Care and Development Block Grant (93.575) .....	2,061		2,062	2,062	2,062
Child Care and Development Fund—Mandatory (93.596a) .....	1,240		1,240	1,240	1,240
Child Care and Development Fund—Matching (93.596b) .....	1,680		1,677	1,677	1,677
Head Start (93.600) .....	6,851		6,789	6,789	6,789
Foster Care—Title IV-E (93.658) .....	4,325		4,475	4,475	4,593
Adoption Assistance (93.659) .....	1,791		2,027	2,027	2,159
Social Services Block Grant (93.667) .....	2,250		1,700	1,700	1,200
<b>Department of Homeland Security, Departmental Management</b>					
Homeland Security Grant Program (97.067) .....	2,033		788	788	265
<b>Department of Homeland Security, Federal Emergency Management Agency</b>					
Disaster Grants—Public Assistance (Presidentially Declared Disasters) (97.036) .....	8,147				
<b>Department of Housing and Urban Development, Public and Indian Housing Programs</b>					
Public Housing Operating Fund (14.850) .....	3,564	1	3,564	3,565	4,000
Section 8 Housing Choice Vouchers (14.871) .....	13,797	724	15,081	15,805	16,000
Public Housing Capital Fund (14.872) .....	2,409	335	2,208	2,543	2,024
<b>Department of Housing and Urban Development, Community Planning and Development</b>					
Community Development Block Grants (14.218) .....	3,823	467	3,888	4,355	2,619
<b>Department of the Interior, Minerals Management Service</b>					
Mineral Leasing and Associated Payments .....	2,113		1,875	1,875	1,995
<b>Department of Transportation, Federal Aviation Administration</b>					
Airport Improvement Program (20.106) .....	3,709		3,514	3,514	2,750
<b>Department of Transportation, Federal Highway Administration</b>					
Highway Planning and Construction (20.205) .....	33,128		35,672	35,672	39,585
<b>Department of Transportation, Federal Transit Administration</b>					
Capital Investment Grants—Fixed Guideway Modernization (Section 5309) (20.500) .....	1,407	197	1,036	1,233	1,701
Federal Transit Formula Grants and Research (20.507) .....	5,534	1,566	3,645	5,211	6,568
<b>Total</b> .....	<b>378,403</b>	<b>3,649</b>	<b>363,779</b>	<b>367,428</b>	<b>382,699</b>

Table 8-6. Summary of Programs by State

(Obligations in millions of dollars)

State or Territory	All programs FY 2006 (actual)	Programs distributed in all years				FY 2008 (estimated)	FY 2008 Percentage of distributed total
		FY 2006 (actual)	Estimated FY 2007 obligations from:				
			Previous authority	New authority	Total		
Alabama .....	5,326	5,326	36	5,104	5,140	5,239	1.40
Alaska .....	1,754	1,754	8	1,741	1,749	1,789	0.48
Arizona .....	6,977	6,977	48	7,264	7,311	7,830	2.10
Arkansas .....	3,857	3,857	12	3,868	3,881	4,160	1.12
California .....	44,287	44,287	465	42,429	42,895	44,570	11.95
Colorado .....	3,590	3,590	17	3,604	3,620	3,788	1.02
Connecticut .....	4,244	4,244	105	4,179	4,285	4,365	1.17
Delaware .....	998	998	4	984	988	1,055	0.28
District of Columbia .....	1,998	1,998	43	1,981	2,024	2,151	0.58
Florida .....	18,461	18,461	244	15,921	16,165	16,638	4.46
Georgia .....	9,432	9,432	105	9,090	9,195	9,799	2.63
Hawaii .....	1,456	1,456	10	1,348	1,358	1,394	0.37
Idaho .....	1,454	1,454	7	1,473	1,480	1,579	0.42
Illinois .....	12,937	12,937	100	12,421	12,521	13,273	3.56
Indiana .....	6,533	6,533	41	6,726	6,767	7,059	1.89
Iowa .....	3,097	3,097	11	3,024	3,034	3,191	0.86
Kansas .....	2,656	2,656	19	2,544	2,563	2,639	0.71
Kentucky .....	5,613	5,613	22	5,544	5,566	5,800	1.56
Louisiana .....	10,060	10,060	58	6,321	6,379	6,740	1.81
Maine .....	2,212	2,212	6	1,807	1,812	1,865	0.50
Maryland .....	5,534	5,534	60	5,505	5,565	5,833	1.56
Massachusetts .....	8,946	8,946	140	9,573	9,714	9,821	2.63
Michigan .....	10,327	10,327	37	10,339	10,376	10,421	2.79
Minnesota .....	5,495	5,495	51	5,503	5,554	6,049	1.62
Mississippi .....	7,116	7,116	23	4,454	4,477	4,786	1.28
Missouri .....	7,037	7,037	33	7,189	7,222	7,604	2.04
Montana .....	1,317	1,317	6	1,224	1,230	1,287	0.35
Nebraska .....	1,994	1,994	7	1,806	1,813	1,892	0.51
Nevada .....	1,767	1,767	19	1,601	1,620	1,634	0.44
New Hampshire .....	1,235	1,235	7	1,203	1,211	1,261	0.34
New Jersey .....	9,391	9,391	82	9,280	9,362	9,781	2.62
New Mexico .....	3,719	3,719	17	3,690	3,706	3,885	1.04
New York .....	38,888	38,888	647	39,090	39,737	39,940	10.71
North Carolina .....	10,192	10,192	64	10,449	10,514	11,954	3.21
North Dakota .....	832	832	-11	758	747	815	0.22
Ohio .....	14,007	14,007	76	14,502	14,578	14,926	4.00
Oklahoma .....	4,169	4,169	18	4,520	4,538	4,687	1.26
Oregon .....	3,886	3,886	14	3,870	3,885	4,119	1.10
Pennsylvania .....	15,985	15,985	165	15,964	16,129	16,757	4.49
Rhode Island .....	1,830	1,830	18	1,743	1,762	1,858	0.50
South Carolina .....	4,909	4,909	25	4,733	4,759	4,769	1.28
South Dakota .....	1,077	1,077	6	1,017	1,023	1,053	0.28
Tennessee .....	7,563	7,563	29	7,228	7,257	7,381	1.98
Texas .....	23,293	23,293	225	23,349	23,574	24,268	6.51
Utah .....	3,202	3,202	37	3,188	3,225	3,370	0.90
Vermont .....	1,065	1,065	3	1,029	1,032	1,087	0.29
Virginia .....	5,317	5,317	53	5,539	5,592	5,901	1.58
Washington .....	6,359	6,359	65	6,119	6,184	6,370	1.71
West Virginia .....	3,121	3,121	16	3,126	3,142	3,313	0.89
Wisconsin .....	5,379	5,379	24	5,456	5,480	5,615	1.51
Wyoming .....	1,861	1,861	7	1,744	1,751	1,853	0.50
American Samoa .....	62	62	2	59	61	61	0.02
Guam .....	132	132	4	135	139	135	0.04
Northern Mariana Islands .....	66	66	2	62	64	57	0.02
Puerto Rico .....	2,347	2,347	62	2,377	2,439	2,488	0.67
Freely Associated States .....	7	7	.....	7	7	7	*
Virgin Islands .....	146	146	4	140	144	146	0.04
Indian Tribes .....	761	761	3	777	780	807	0.22
<b>Total, programs distributed by State in all years .....</b>	<b>367,278</b>	<b>367,278</b>	<b>3,403</b>	<b>355,721</b>	<b>359,124</b>	<b>372,917</b>	<b>100.00</b>
<b>MEMORANDUM:</b>							
Not distributed by State in all years <sup>1</sup> .....	11,125	11,125	245	8,059	8,304	9,782	N/A
Total, including undistributed .....	378,403	378,403	3,649	363,779	367,428	382,699	N/A

\* \$500,000 or less or 0.005 percent or less.

<sup>1</sup> The sum of programs not distributed by State in all years.

**Table 8-7. School Breakfast Program (10.553)**

(Obligations in thousands of dollars)

State or Territory	FY 2006 Actual	Estimated FY 2007 obligations from:			FY 2008 (estimated)	FY 2008 Percentage of distributed total
		Previous authority	New authority	Total		
Alabama	39,539		43,632	43,632	46,529	1.95
Alaska	4,986		5,502	5,502	5,867	0.25
Arizona	41,125		45,382	45,382	48,395	2.02
Arkansas	29,311		32,345	32,345	34,493	1.44
California	244,215		269,500	269,500	287,386	12.02
Colorado	17,157		18,933	18,933	20,190	0.84
Connecticut	12,828		14,156	14,156	15,096	0.63
Delaware	4,899		5,406	5,406	5,765	0.24
District of Columbia	4,117		4,543	4,543	4,845	0.20
Florida	119,072		131,399	131,399	140,121	5.86
Georgia	102,069		112,635	112,635	120,113	5.03
Hawaii	7,321		8,079	8,079	8,615	0.36
Idaho	10,408		11,485	11,485	12,248	0.51
Illinois	57,686		63,658	63,658	67,884	2.84
Indiana	33,279		36,724	36,724	39,162	1.64
Iowa	13,470		14,864	14,864	15,851	0.66
Kansas	15,434		17,032	17,032	18,162	0.76
Kentucky	42,329		46,711	46,711	49,812	2.08
Louisiana	45,828		50,572	50,572	53,929	2.26
Maine	6,033		6,658	6,658	7,099	0.30
Maryland	23,746		26,204	26,204	27,944	1.17
Massachusetts	26,919		29,706	29,706	31,678	1.33
Michigan	46,487		51,299	51,299	54,705	2.29
Minnesota	21,505		23,731	23,731	25,307	1.06
Mississippi	42,730		47,154	47,154	50,284	2.10
Missouri	40,822		45,048	45,048	48,038	2.01
Montana	4,495		4,960	4,960	5,290	0.22
Nebraska	8,713		9,615	9,615	10,253	0.43
Nevada	11,783		13,003	13,003	13,866	0.58
New Hampshire	3,069		3,387	3,387	3,612	0.15
New Jersey	34,067		37,594	37,594	40,089	1.68
New Mexico	26,354		29,082	29,082	31,013	1.30
New York	111,431		122,967	122,967	131,129	5.49
North Carolina	73,581		81,198	81,198	86,588	3.62
North Dakota	2,808		3,099	3,099	3,304	0.14
Ohio	56,991		62,891	62,891	67,066	2.81
Oklahoma	36,521		40,302	40,302	42,977	1.80
Oregon	25,748		28,413	28,413	30,300	1.27
Pennsylvania	50,475		55,700	55,700	59,398	2.49
Rhode Island	5,160		5,694	5,694	6,072	0.25
South Carolina	46,550		51,369	51,369	54,779	2.29
South Dakota	4,852		5,354	5,354	5,710	0.24
Tennessee	48,591		53,621	53,621	57,181	2.39
Texas	277,837		306,599	306,599	326,952	13.68
Utah	11,292		12,461	12,461	13,288	0.56
Vermont	3,184		3,514	3,514	3,747	0.16
Virginia	38,462		42,444	42,444	45,261	1.89
Washington	30,440		33,591	33,591	35,821	1.50
West Virginia	17,048		18,813	18,813	20,062	0.84
Wisconsin	16,933		18,686	18,686	19,926	0.83
Wyoming	2,202		2,430	2,430	2,591	0.11
American Samoa						
Guam	1,753		1,934	1,934	2,063	0.09
Northern Mariana Islands						
Puerto Rico	26,392		29,124	29,124	31,058	1.30
Freely Associated States						
Virgin Islands	883		974	974	1,039	0.04
Indian Tribes						
Undistributed	55,138					
DOD/AF/USMC/Navy	30		33	33	35	*
<b>Total</b>	<b>2,086,098</b>		<b>2,241,210</b>	<b>2,241,210</b>	<b>2,389,988</b>	<b>1 100.00</b>

\* \$500 or less or 0.005 percent or less.

1 Excludes undistributed obligations.

**Table 8-8. National School Lunch Program (10.555)**

(Obligations in thousands of dollars)

State or Territory	FY 2006 Actual	Estimated FY 2007 obligations from:			FY 2008 (estimated)	FY 2008 Percentage of distributed total
		Previous authority	New authority	Total		
Alabama	140,626	1,210	149,087	150,297	156,532	1.91
Alaska	23,222	200	24,619	24,819	25,849	0.32
Arizona	163,074	1,403	172,886	174,289	181,519	2.22
Arkansas	88,703	763	94,040	94,803	98,736	1.21
California	960,948	8,264	1,018,766	1,027,030	1,069,640	13.07
Colorado	77,686	668	82,360	83,028	86,473	1.06
Connecticut	59,462	512	63,040	63,552	66,188	0.81
Delaware	16,666	143	17,669	17,812	18,551	0.23
District of Columbia	14,649	126	15,530	15,656	16,306	0.20
Florida	404,115	3,477	428,430	431,907	449,824	5.50
Georgia	310,125	2,668	328,785	331,453	345,203	4.22
Hawaii	28,354	244	30,060	30,304	31,561	0.39
Idaho	33,922	292	35,963	36,255	37,759	0.46
Illinois	284,408	2,447	301,520	303,967	316,577	3.87
Indiana	138,480	1,191	146,812	148,003	154,143	1.88
Iowa	62,924	541	66,710	67,251	70,041	0.86
Kansas	62,606	539	66,373	66,912	69,687	0.85
Kentucky	122,667	1,055	130,048	131,103	136,542	1.67
Louisiana	151,869	1,307	161,007	162,314	169,047	2.07
Maine	22,453	193	23,804	23,997	24,993	0.31
Maryland	91,658	789	97,173	97,962	102,025	1.25
Massachusetts	102,191	879	108,340	109,219	113,750	1.39
Michigan	184,249	1,585	195,335	196,920	205,089	2.51
Minnesota	94,387	812	100,066	100,878	105,063	1.28
Mississippi	126,244	1,086	133,840	134,926	140,523	1.72
Missouri	134,630	1,158	142,730	143,888	149,858	1.83
Montana	17,621	152	18,681	18,833	19,614	0.24
Nebraska	40,006	344	42,413	42,757	44,531	0.54
Nevada	48,854	420	51,793	52,213	54,380	0.66
New Hampshire	15,765	136	16,714	16,850	17,548	0.21
New Jersey	145,162	1,249	153,896	155,145	161,581	1.98
New Mexico	64,259	553	68,125	68,678	71,527	0.87
New York	463,599	3,988	491,493	495,481	516,036	6.31
North Carolina	236,140	2,031	250,348	252,379	262,849	3.21
North Dakota	12,135	104	12,865	12,969	13,508	0.17
Ohio	219,989	1,893	233,225	235,118	244,872	2.99
Oklahoma	106,373	915	112,773	113,688	118,405	1.45
Oregon	72,946	628	77,335	77,963	81,197	0.99
Pennsylvania	225,243	1,938	238,795	240,733	250,720	3.06
Rhode Island	20,103	173	21,313	21,486	22,377	0.27
South Carolina	130,187	1,120	138,020	139,140	144,912	1.77
South Dakota	19,154	165	20,306	20,471	21,320	0.26
Tennessee	161,539	1,390	171,258	172,648	179,810	2.20
Texas	846,828	7,285	897,780	905,065	942,612	11.52
Utah	57,542	495	61,004	61,499	64,050	0.78
Vermont	9,612	83	10,190	10,273	10,699	0.13
Virginia	140,682	1,210	149,147	150,357	156,594	1.91
Washington	119,857	1,031	127,069	128,100	133,414	1.63
West Virginia	46,223	398	49,004	49,402	51,451	0.63
Wisconsin	100,393	864	106,433	107,297	111,748	1.37
Wyoming	9,322	80	9,883	9,963	10,376	0.13
American Samoa						
Guam	5,610	48	5,948	5,996	6,245	0.08
Northern Mariana Islands						
Puerto Rico	104,369	898	110,649	111,547	116,174	1.42
Freely Associated States						
Virgin Islands	4,506	39	4,777	4,816	5,016	0.06
Indian Tribes						
Undistributed	220,130					
DOD/AF/USMC/Navy	5,290	46	5,608	5,654	5,888	0.07
<b>Total</b>	<b>7,569,757</b>	<b>63,228</b>	<b>7,791,838</b>	<b>7,855,066</b>	<b>8,180,933</b>	<b>1 100.00</b>

<sup>1</sup> Excludes undistributed obligations.

**Table 8-9. Special Supplemental Nutrition Program for Women, Infants, and Children (WIC) (10.557)**

(Obligations in thousands of dollars)

State or Territory	FY 2006 Actual	Estimated FY 2007 obligations from:			FY 2008 (estimated)	FY 2008 Percentage of distributed total
		Previous authority	New authority	Total		
Alabama	87,836	4,877	84,604	89,481	90,045	1.65
Alaska	22,813	1,267	21,974	23,241	23,387	0.43
Arizona	95,434	5,298	91,922	97,220	97,834	1.80
Arkansas	55,944	3,106	53,885	56,991	57,351	1.05
California	891,953	49,519	859,130	908,649	914,380	16.78
Colorado	53,928	2,994	51,944	54,938	55,284	1.01
Connecticut	37,059	2,057	35,695	37,752	37,991	0.70
Delaware	12,506	694	12,046	12,740	12,821	0.24
District of Columbia	12,890	716	12,416	13,132	13,214	0.24
Florida	253,231	14,059	243,913	257,972	259,599	4.76
Georgia	174,247	9,674	167,835	177,509	178,629	3.28
Hawaii	29,836	1,656	28,738	30,394	30,586	0.56
Idaho	21,077	1,170	20,301	21,471	21,607	0.40
Illinois	193,217	10,727	186,107	196,834	198,076	3.64
Indiana	79,808	4,431	76,871	81,302	81,815	1.50
Iowa	39,774	2,208	38,310	40,518	40,774	0.75
Kansas	38,076	2,114	36,675	38,789	39,034	0.72
Kentucky	83,488	4,635	80,416	85,051	85,588	1.57
Louisiana	100,807	5,597	97,098	102,695	103,342	1.90
Maine	14,828	823	14,282	15,105	15,201	0.28
Maryland	69,093	3,836	66,551	70,387	70,831	1.30
Massachusetts	75,840	4,211	73,049	77,260	77,747	1.43
Michigan	146,696	8,144	141,298	149,442	150,385	2.76
Minnesota	77,642	4,311	74,785	79,096	79,595	1.46
Mississippi	67,537	3,750	65,052	68,802	69,235	1.27
Missouri	80,188	4,452	77,237	81,689	82,205	1.51
Montana	13,088	727	12,606	13,333	13,417	0.25
Nebraska	25,542	1,418	24,602	26,020	26,184	0.48
Nevada	29,027	1,612	27,959	29,571	29,757	0.55
New Hampshire	13,165	731	12,681	13,412	13,496	0.25
New Jersey	98,738	5,482	95,105	100,587	101,221	1.86
New Mexico	38,206	2,121	36,800	38,921	39,167	0.72
New York	350,694	19,470	337,789	357,259	359,513	6.60
North Carolina	146,997	8,161	141,588	149,749	150,694	2.77
North Dakota	9,440	524	9,093	9,617	9,677	0.18
Ohio	165,805	9,205	159,704	168,909	169,975	3.12
Oklahoma	56,573	3,141	54,491	57,632	57,996	1.06
Oregon	63,983	3,552	61,629	65,181	65,592	1.20
Pennsylvania	141,741	7,869	136,525	144,394	145,306	2.67
Rhode Island	16,335	907	15,734	16,641	16,746	0.31
South Carolina	72,970	4,051	70,285	74,336	74,805	1.37
South Dakota	12,259	681	11,808	12,489	12,567	0.23
Tennessee	108,469	6,022	104,478	110,500	111,197	2.04
Texas	498,446	27,673	480,104	507,777	510,981	9.38
Utah	34,826	1,933	33,544	35,477	35,702	0.66
Vermont	11,918	662	11,479	12,141	12,218	0.22
Virginia	95,059	5,278	91,561	96,839	97,450	1.79
Washington	111,441	6,187	107,340	113,527	114,244	2.10
West Virginia	32,286	1,792	31,098	32,890	33,098	0.61
Wisconsin	72,010	3,998	69,360	73,358	73,821	1.35
Wyoming	7,067	392	6,807	7,199	7,245	0.13
American Samoa	6,903	383	6,649	7,032	7,077	0.13
Guam	7,023	390	6,765	7,155	7,200	0.13
Northern Mariana Islands	4,636	257	4,465	4,722	4,753	0.09
Puerto Rico	199,223	11,061	191,892	202,953	204,233	3.75
Freely Associated States						
Virgin Islands	5,521	307	5,318	5,625	5,660	0.10
Indian Tribes	49,982	2,775	48,143	50,918	51,239	0.94
Undistributed	47,706		48,510	48,510	28,710	
<b>Total</b>	<b>5,362,827</b>	<b>295,088</b>	<b>5,168,046</b>	<b>5,463,134</b>	<b>5,477,497</b>	<b>1 100.00</b>

<sup>1</sup> Excludes undistributed obligations.

**Table 8-10. Child and Adult Care Food Program (10.558)**

(Obligations in thousands of dollars)

State or Territory	FY 2006 Actual	Estimated FY 2007 obligations from:			FY 2008 (estimated)	FY 2008 Percentage of distributed total
		Previous authority	New authority	Total		
Alabama	33,900		35,409	35,409	37,306	1.63
Alaska	7,186		7,506	7,506	7,908	0.35
Arizona	42,853		44,761	44,761	47,159	2.06
Arkansas	28,448		29,715	29,715	31,306	1.37
California	241,873		252,641	252,641	266,176	11.63
Colorado	18,856		19,696	19,696	20,751	0.91
Connecticut	10,695		11,171	11,171	11,770	0.51
Delaware	10,350		10,811	10,811	11,390	0.50
District of Columbia	3,617		3,778	3,778	3,980	0.17
Florida	111,034		115,978	115,978	122,191	5.34
Georgia	81,193		84,808	84,808	89,351	3.90
Hawaii	4,791		5,004	5,004	5,272	0.23
Idaho	5,103		5,330	5,330	5,616	0.25
Illinois	97,786		102,140	102,140	107,612	4.70
Indiana	30,736		32,105	32,105	33,824	1.48
Iowa	20,628		21,546	21,546	22,701	0.99
Kansas	30,047		31,385	31,385	33,066	1.44
Kentucky	24,717		25,818	25,818	27,201	1.19
Louisiana	46,106		48,159	48,159	50,739	2.22
Maine	9,228		9,639	9,639	10,155	0.44
Maryland	33,230		34,710	34,710	36,569	1.60
Massachusetts	43,298		45,226	45,226	47,649	2.08
Michigan	51,046		53,319	53,319	56,175	2.45
Minnesota	54,276		56,693	56,693	59,730	2.61
Mississippi	27,274		28,488	28,488	30,015	1.31
Missouri	39,093		40,834	40,834	43,021	1.88
Montana	9,101		9,506	9,506	10,015	0.44
Nebraska	23,079		24,107	24,107	25,398	1.11
Nevada	4,033		4,213	4,213	4,438	0.19
New Hampshire	2,844		2,971	2,971	3,130	0.14
New Jersey	50,258		52,496	52,496	55,308	2.42
New Mexico	34,496		36,032	36,032	37,962	1.66
New York	149,995		156,674	156,674	165,067	7.21
North Carolina	72,377		75,600	75,600	79,650	3.48
North Dakota	9,107		9,513	9,513	10,022	0.44
Ohio	63,168		65,981	65,981	69,515	3.04
Oklahoma	48,927		51,106	51,106	53,843	2.35
Oregon	22,757		23,770	23,770	25,044	1.09
Pennsylvania	57,680		60,248	60,248	63,476	2.77
Rhode Island	7,168		7,487	7,487	7,888	0.34
South Carolina	23,274		24,310	24,310	25,613	1.12
South Dakota	6,627		6,922	6,922	7,293	0.32
Tennessee	39,977		41,757	41,757	43,994	1.92
Texas	181,695		189,785	189,785	199,952	8.74
Utah	19,162		20,015	20,015	21,087	0.92
Vermont	3,912		4,086	4,086	4,305	0.19
Virginia	28,391		29,655	29,655	31,244	1.37
Washington	37,874		39,560	39,560	41,680	1.82
West Virginia	14,741		15,397	15,397	16,222	0.71
Wisconsin	34,508		36,045	36,045	37,975	1.66
Wyoming	4,844		5,060	5,060	5,331	0.23
American Samoa						
Guam	53		55	55	58	*
Northern Mariana Islands						
Puerto Rico	21,786		22,756	22,756	23,975	1.05
Freely Associated States						
Virgin Islands	654		683	683	720	0.03
Indian Tribes						
Undistributed	61,236					
<b>Total</b>	<b>2,141,088</b>		<b>2,172,460</b>	<b>2,172,460</b>	<b>2,288,838</b>	<b>1 100.00</b>

\* \$500 or less or 0.005 percent or less.

<sup>1</sup> Excludes undistributed obligations.



**Table 8-11. State Administrative Matching Grants for Food Stamp Program (10.561)**

(Obligations in thousands of dollars)

State or Territory	FY 2006 Actual	Estimated FY 2007 obligations from:			FY 2008 (estimated)	FY 2008 Percentage of distributed total
		Previous authority	New authority	Total		
Alabama	30,789		30,616	30,616	31,948	1.20
Alaska	9,742		9,687	9,687	10,109	0.38
Arizona	32,769		32,585	32,585	34,002	1.28
Arkansas	24,277		24,140	24,140	25,191	0.95
California	435,360		432,909	432,909	451,744	16.97
Colorado	23,694		23,560	23,560	24,585	0.92
Connecticut	21,748		21,625	21,625	22,566	0.85
Delaware	8,664		8,615	8,615	8,990	0.34
District of Columbia	13,451		13,375	13,375	13,957	0.52
Florida	72,355		71,947	71,947	75,078	2.82
Georgia	59,420		59,085	59,085	61,656	2.32
Hawaii	10,917		10,855	10,855	11,328	0.43
Idaho	8,537		8,489	8,489	8,858	0.33
Illinois	91,040		90,528	90,528	94,467	3.55
Indiana	37,385		37,175	37,175	38,792	1.46
Iowa	16,632		16,538	16,538	17,258	0.65
Kansas	17,303		17,206	17,206	17,954	0.67
Kentucky	30,079		29,909	29,909	31,211	1.17
Louisiana	47,744		47,475	47,475	49,541	1.86
Maine	8,270		8,224	8,224	8,582	0.32
Maryland	34,940		34,743	34,743	36,255	1.36
Massachusetts	39,858		39,634	39,634	41,359	1.55
Michigan	93,105		92,581	92,581	96,609	3.63
Minnesota	41,159		40,928	40,928	42,708	1.60
Mississippi	26,503		26,353	26,353	27,500	1.03
Missouri	35,284		35,085	35,085	36,612	1.38
Montana	8,211		8,165	8,165	8,520	0.32
Nebraska	14,673		14,591	14,591	15,226	0.57
Nevada	12,692		12,620	12,620	13,170	0.49
New Hampshire	5,354		5,324	5,324	5,556	0.21
New Jersey	89,092		88,591	88,591	92,446	3.47
New Mexico	18,424		18,321	18,321	19,118	0.72
New York	276,857		275,299	275,299	287,277	10.79
North Carolina	66,199		65,826	65,826	68,690	2.58
North Dakota	6,669		6,631	6,631	6,920	0.26
Ohio	100,137		99,573	99,573	103,906	3.90
Oklahoma	42,224		41,987	41,987	43,814	1.65
Oregon	45,328		45,073	45,073	47,034	1.77
Pennsylvania	136,979		136,208	136,208	142,135	5.34
Rhode Island	7,733		7,690	7,690	8,024	0.30
South Carolina	21,274		21,154	21,154	22,074	0.83
South Dakota	7,221		7,180	7,180	7,493	0.28
Tennessee	42,800		42,560	42,560	44,411	1.67
Texas	179,510		178,500	178,500	186,267	7.00
Utah	20,024		19,911	19,911	20,778	0.78
Vermont	5,862		5,829	5,829	6,083	0.23
Virginia	79,531		79,083	79,083	82,524	3.10
Washington	48,976		48,701	48,701	50,820	1.91
West Virginia	13,746		13,668	13,668	14,263	0.54
Wisconsin	34,291		34,098	34,098	35,582	1.34
Wyoming	3,951		3,929	3,929	4,100	0.15
American Samoa						
Guam	2,517		2,503	2,503	2,612	0.10
Northern Mariana Islands						
Puerto Rico						
Freely Associated States						
Virgin Islands	4,141		4,118	4,118	4,297	0.16
Indian Tribes						
Undistributed	-110,543					
<b>Total</b>	<b>2,454,896</b>		<b>2,551,000</b>	<b>2,551,000</b>	<b>2,662,000</b>	<b>1 100.00</b>

<sup>1</sup> Excludes undistributed obligations.

**Table 8-12. Title I Grants to Local Educational Agencies (84.010)**

(Obligations in thousands of dollars)

State or Territory	FY 2006 Actual	Estimated FY 2007 obligations from:			FY 2008 (estimated)	FY 2008 Percentage of distributed total
		Previous authority	New authority	Total		
Alabama	199,115		192,920	192,920	209,039	1.50
Alaska	33,134		33,536	33,536	37,170	0.27
Arizona	260,348		261,506	261,506	285,534	2.05
Arkansas	125,531		121,264	121,264	129,523	0.93
California	1,723,483		1,614,040	1,614,040	1,767,658	12.71
Colorado	129,040		123,166	123,166	133,331	0.96
Connecticut	100,364		110,619	110,619	118,876	0.85
Delaware	33,835		33,734	33,734	37,399	0.27
District of Columbia	48,702		45,943	45,943	49,867	0.36
Florida	648,780		585,698	585,698	639,516	4.60
Georgia	411,619		407,228	407,228	443,327	3.19
Hawaii	45,972		39,302	39,302	41,042	0.30
Idaho	42,377		40,901	40,901	44,932	0.32
Illinois	539,610		588,963	588,963	652,228	4.69
Indiana	184,340		227,419	227,419	246,398	1.77
Iowa	64,917		68,486	68,486	73,268	0.53
Kansas	81,640		84,542	84,542	90,976	0.65
Kentucky	184,219		182,269	182,269	196,261	1.41
Louisiana	283,726		275,087	275,087	298,264	2.14
Maine	45,516		43,353	43,353	47,250	0.34
Maryland	171,998		186,326	186,326	206,301	1.48
Massachusetts	207,264		210,251	210,251	226,515	1.63
Michigan	426,805		456,631	456,631	499,236	3.59
Minnesota	109,156		114,399	114,399	123,385	0.89
Mississippi	170,367		171,499	171,499	185,338	1.33
Missouri	188,075		201,220	201,220	217,710	1.57
Montana	40,962		38,273	38,273	41,722	0.30
Nebraska	50,562		50,587	50,587	54,588	0.39
Nevada	76,712		79,068	79,068	88,390	0.64
New Hampshire	31,001		34,313	34,313	37,977	0.27
New Jersey	265,388		249,374	249,374	265,576	1.91
New Mexico	112,418		103,003	103,003	107,860	0.78
New York	1,205,156		1,197,913	1,197,913	1,335,800	9.60
North Carolina	292,733		298,503	298,503	325,485	2.34
North Dakota	30,068		29,515	29,515	32,712	0.24
Ohio	410,461		445,977	445,977	484,906	3.49
Oklahoma	140,733		126,946	126,946	132,886	0.96
Oregon	130,590		121,175	121,175	129,518	0.93
Pennsylvania	483,257		513,126	513,126	561,163	4.03
Rhode Island	47,136		49,795	49,795	54,372	0.39
South Carolina	177,541		185,909	185,909	202,199	1.45
South Dakota	36,392		36,775	36,775	40,915	0.29
Tennessee	205,049		204,431	204,431	222,890	1.60
Texas	1,186,021		1,158,900	1,158,900	1,261,370	9.07
Utah	54,087		57,543	57,543	62,767	0.45
Vermont	28,355		26,896	26,896	29,788	0.21
Virginia	208,012		203,783	203,783	220,745	1.59
Washington	175,975		181,353	181,353	195,986	1.41
West Virginia	99,180		88,808	88,808	90,874	0.65
Wisconsin	154,633		200,471	200,471	218,836	1.57
Wyoming	28,892		27,643	27,643	30,684	0.22
American Samoa	8,494		8,436	8,436	9,406	0.07
Guam	10,290		9,261	9,261	8,387	0.06
Northern Mariana Islands	3,477		3,303	3,303	3,551	0.03
Puerto Rico	451,345		452,318	452,318	536,485	3.86
Freely Associated States						
Virgin Islands	11,413		11,336	11,336	12,639	0.09
Indian Tribes	88,423		89,762	89,762	100,076	0.72
Undistributed						
Census	3,437		3,437	3,437	4,000	0.03
Pacific Regional Education Lab	5,000		5,000	5,000	5,000	0.04
<b>Total</b>	<b>12,713,125</b>		<b>12,713,233</b>	<b>12,713,233</b>	<b>13,909,900</b>	<b>100.00</b>

<sup>1</sup> Excludes undistributed obligations.

**Table 8-13. Improving Teacher Quality State Grants (84.367)**

(Obligations in thousands of dollars)

State or Territory	FY 2006 Actual	Estimated FY 2007 obligations from:			FY 2008 (estimated)	FY 2008 Percentage of distributed total
		Previous authority	New authority	Total		
Alabama	46,150		46,151	46,151	44,496	1.60
Alaska	13,752		13,752	13,752	13,259	0.48
Arizona	48,147		48,148	48,148	45,973	1.66
Arkansas	28,203		28,203	28,203	27,163	0.98
California	335,451		335,457	335,457	322,115	11.61
Colorado	32,312		32,313	32,313	31,117	1.12
Connecticut	26,179		26,179	26,179	25,400	0.92
Delaware	13,752		13,752	13,752	13,259	0.48
District of Columbia	13,752		13,752	13,752	13,259	0.48
Florida	134,653		134,655	134,655	129,262	4.66
Georgia	77,237		77,239	77,239	74,165	2.67
Hawaii	13,752		13,752	13,752	13,259	0.48
Idaho	13,752		13,752	13,752	13,259	0.48
Illinois	116,334		116,336	116,336	112,548	4.06
Indiana	47,998		47,999	47,999	46,366	1.67
Iowa	21,617		21,618	21,618	20,960	0.76
Kansas	22,209		22,209	22,209	21,515	0.78
Kentucky	44,228		44,229	44,229	42,819	1.54
Louisiana	64,350		64,351	64,351	62,372	2.25
Maine	13,752		13,752	13,752	13,259	0.48
Maryland	41,277		41,278	41,278	39,938	1.44
Massachusetts	50,505		50,506	50,506	49,056	1.77
Michigan	108,504		108,505	108,505	105,577	3.81
Minnesota	37,545		37,545	37,545	36,445	1.31
Mississippi	41,918		41,919	41,919	40,606	1.46
Missouri	49,119		49,120	49,120	47,466	1.71
Montana	13,752		13,752	13,752	13,259	0.48
Nebraska	14,029		14,029	14,029	13,536	0.49
Nevada	15,208		15,208	15,208	14,524	0.52
New Hampshire	13,752		13,752	13,752	13,259	0.48
New Jersey	64,457		64,458	64,458	62,398	2.25
New Mexico	23,007		23,007	23,007	22,186	0.80
New York	228,755		228,758	228,758	222,219	8.01
North Carolina	64,910		64,912	64,912	62,230	2.24
North Dakota	13,752		13,752	13,752	13,259	0.48
Ohio	103,564		103,566	103,566	100,485	3.62
Oklahoma	33,350		33,350	33,350	32,147	1.16
Oregon	28,259		28,260	28,260	27,220	0.98
Pennsylvania	112,880		112,881	112,881	109,650	3.95
Rhode Island	13,752		13,752	13,752	13,259	0.48
South Carolina	36,834		36,835	36,835	35,403	1.28
South Dakota	13,752		13,752	13,752	13,259	0.48
Tennessee	49,235		49,236	49,236	47,408	1.71
Texas	239,613		239,617	239,617	230,552	8.31
Utah	18,476		18,476	18,476	17,818	0.64
Vermont	13,752		13,752	13,752	13,259	0.48
Virginia	51,710		51,711	51,711	49,857	1.80
Washington	47,045		47,046	47,046	45,399	1.64
West Virginia	23,520		23,521	23,521	22,900	0.83
Wisconsin	44,988		44,989	44,989	43,715	1.58
Wyoming	13,752		13,752	13,752	13,259	0.48
American Samoa	3,416		3,416	3,416	3,281	0.12
Guam	5,057		5,057	5,057	4,895	0.18
Northern Mariana Islands	1,611		1,611	1,611	1,551	0.06
Puerto Rico	91,727		91,729	91,729	88,438	3.19
Freely Associated States						
Virgin Islands	4,281		4,281	4,281	4,141	0.15
Indian Tribes	14,365		14,365	14,365	13,868	0.50
Undistributed	14,437		14,437	14,437	13,937	
<b>Total</b>	<b>2,887,439</b>		<b>2,887,488</b>	<b>2,887,488</b>	<b>2,787,488</b>	<b>1 100.00</b>

<sup>1</sup> Excludes undistributed obligations.

**Table 8-14. Special Education—Grants to States (84.027)**

(Obligations in thousands of dollars)

State or Territory	FY 2006 Actual	Estimated FY 2007 obligations from:			FY 2008 (estimated)	FY 2008 Percentage of distributed total
		Previous authority	New authority	Total		
Alabama	167,635		166,195	166,195	166,195	1.58
Alaska	32,452		32,157	32,157	32,157	0.31
Arizona	162,328		160,852	160,852	160,852	1.53
Arkansas	103,400		102,488	102,488	102,488	0.98
California	1,130,940		1,120,726	1,120,726	1,120,726	10.68
Colorado	137,481		136,232	136,232	136,232	1.30
Connecticut	122,567		121,552	121,552	121,552	1.16
Delaware	29,742		29,471	29,471	29,471	0.28
District of Columbia	14,954		14,818	14,818	14,818	0.14
Florida	580,457		575,467	575,467	575,467	5.48
Georgia	285,369		282,776	282,776	282,776	2.70
Hawaii	36,801		36,471	36,471	36,471	0.35
Idaho	50,036		49,584	49,584	49,584	0.47
Illinois	466,850		462,872	462,872	462,872	4.41
Indiana	235,740		233,778	233,778	233,778	2.23
Iowa	112,542		111,615	111,615	111,615	1.06
Kansas	98,509		97,661	97,661	97,661	0.93
Kentucky	145,505		144,269	144,269	144,269	1.38
Louisiana	174,506		172,920	172,920	172,920	1.65
Maine	50,442		50,027	50,027	50,027	0.48
Maryland	184,574		183,007	183,007	183,007	1.74
Massachusetts	261,681		259,526	259,526	259,526	2.47
Michigan	369,262		365,972	365,972	365,972	3.49
Minnesota	174,985		173,502	173,502	173,502	1.65
Mississippi	109,703		108,724	108,724	108,724	1.04
Missouri	209,400		207,671	207,671	207,671	1.98
Montana	33,879		33,574	33,574	33,574	0.32
Nebraska	68,834		68,267	68,267	68,267	0.65
Nevada	61,046		60,492	60,492	60,492	0.58
New Hampshire	43,748		43,387	43,387	43,387	0.41
New Jersey	333,206		330,463	330,463	330,463	3.15
New Mexico	84,016		83,315	83,315	83,315	0.79
New York	699,789		693,935	693,935	693,935	6.61
North Carolina	288,431		285,889	285,889	285,889	2.72
North Dakota	24,150		23,930	23,930	23,930	0.23
Ohio	403,485		399,918	399,918	399,918	3.81
Oklahoma	136,350		135,170	135,170	135,170	1.29
Oregon	118,887		117,857	117,857	117,857	1.12
Pennsylvania	393,753		390,290	390,290	390,290	3.72
Rhode Island	40,312		39,980	39,980	39,980	0.38
South Carolina	161,465		160,107	160,107	160,107	1.53
South Dakota	28,769		28,507	28,507	28,507	0.27
Tennessee	214,982		213,139	213,139	213,139	2.03
Texas	888,269		880,215	880,215	880,215	8.39
Utah	98,327		97,444	97,444	97,444	0.93
Vermont	23,285		23,074	23,074	23,074	0.22
Virginia	259,641		257,403	257,403	257,403	2.45
Washington	204,037		202,211	202,211	202,211	1.93
West Virginia	70,009		69,433	69,433	69,433	0.66
Wisconsin	191,909		190,281	190,281	190,281	1.81
Wyoming	24,428		24,206	24,206	24,206	0.23
American Samoa	6,122		6,110	6,110	6,110	0.06
Guam	13,575		13,547	13,547	13,547	0.13
Northern Mariana Islands	4,652		4,643	4,643	4,643	0.04
Puerto Rico	99,227		98,325	98,325	98,325	0.94
Freely Associated States	6,579		6,579	6,579	6,579	0.06
Virgin Islands	8,628		8,611	8,611	8,611	0.08
Indian Tribes	86,306		86,306	86,306	86,306	0.82
Undistributed						
Technical Assistance	15,000		15,000	15,000	15,000	0.14
<b>Total</b>	<b>10,582,961</b>		<b>10,491,941</b>	<b>10,491,941</b>	<b>10,491,941</b>	<b>1 100.00</b>

<sup>1</sup> Excludes undistributed obligations.

**Table 8-15. Rehabilitation Services—Vocational Rehabilitation Grants to States (84.126)**

(Obligations in thousands of dollars)

State or Territory	FY 2006 Actual	Estimated FY 2007 obligations from:			FY 2008 (estimated)	FY 2008 Percentage of distributed total
		Previous authority	New authority	Total		
Alabama	55,858		56,445	56,445	55,155	1.94
Alaska	8,994		9,342	9,342	9,342	0.33
Arizona	51,413		56,407	56,407	57,084	2.01
Arkansas	34,986		35,708	35,708	35,365	1.25
California	260,883		271,453	271,453	271,762	9.58
Colorado	32,548		34,105	34,105	35,528	1.25
Connecticut	19,462		19,871	19,871	19,720	0.70
Delaware	9,004		9,342	9,342	9,342	0.33
District of Columbia	12,250		12,182	12,182	12,492	0.44
Florida	140,570		154,109	154,109	150,676	5.31
Georgia	81,909		86,685	86,685	91,012	3.21
Hawaii	10,749		11,255	11,255	10,900	0.38
Idaho	14,723		15,465	15,465	15,648	0.55
Illinois	100,712		103,911	103,911	103,891	3.66
Indiana	63,749		66,226	66,226	65,825	2.32
Iowa	30,428		31,581	31,581	30,768	1.08
Kansas	25,966		26,963	26,963	26,583	0.94
Kentucky	49,003		50,877	50,877	51,115	1.80
Louisiana	54,442		56,315	56,315	55,711	1.96
Maine	15,047		14,885	14,885	14,854	0.52
Maryland	39,360		39,069	39,069	37,646	1.33
Massachusetts	44,839		45,164	45,164	45,051	1.59
Michigan	92,608		95,240	95,240	96,112	3.39
Minnesota	41,955		43,338	43,338	42,601	1.50
Mississippi	40,552		41,031	41,031	40,799	1.44
Missouri	59,109		61,039	61,039	61,268	2.16
Montana	10,650		10,907	10,907	10,624	0.37
Nebraska	17,112		17,540	17,540	17,140	0.60
Nevada	16,598		17,844	17,844	17,653	0.62
New Hampshire	10,238		10,574	10,574	10,605	0.37
New Jersey	52,405		54,175	54,175	54,539	1.92
New Mexico	21,894		22,360	22,360	22,386	0.79
New York	142,194		146,134	146,134	145,603	5.13
North Carolina	83,840		90,329	90,329	91,614	3.23
North Dakota	8,957		9,342	9,342	9,342	0.33
Ohio	114,994		118,397	118,397	118,931	4.19
Oklahoma	39,002		40,565	40,565	40,118	1.41
Oregon	33,265		34,855	34,855	34,701	1.22
Pennsylvania	118,964		121,735	121,735	119,677	4.22
Rhode Island	9,972		10,276	10,276	9,932	0.35
South Carolina	47,937		49,595	49,595	50,089	1.77
South Dakota	9,018		9,342	9,342	9,342	0.33
Tennessee	63,092		64,866	64,866	64,763	2.28
Texas	201,770		212,142	212,142	214,752	7.57
Utah	25,154		26,821	26,821	27,637	0.97
Vermont	8,999		9,342	9,342	9,342	0.33
Virginia	60,880		62,457	62,457	61,302	2.16
Washington	46,907		48,831	48,831	50,423	1.78
West Virginia	25,011		24,796	24,796	25,018	0.88
Wisconsin	52,854		54,832	54,832	54,572	1.92
Wyoming	8,194		9,342	9,342	9,342	0.33
American Samoa	891		924	924	916	0.03
Guam	1,289		2,831	2,831	2,840	0.10
Northern Mariana Islands	1,055		1,126	1,126	1,142	0.04
Puerto Rico	60,974		70,460	70,460	70,167	2.47
Freely Associated States						
Virgin Islands	1,936		1,965	1,965	1,951	0.07
Indian Tribes	33,024		34,444	34,444	34,444	1.21
Undistributed						
<b>Total</b>	<b>2,720,192</b>		<b>2,837,160</b>	<b>2,837,160</b>	<b>2,837,160</b>	<b>1 100.00</b>

<sup>1</sup> Excludes undistributed obligations.

**Table 8-16. State Children’s Health Insurance Program (93.767)**

(Obligations in thousands of dollars)

State or Territory	FY 2006 Actual	Estimated FY 2007 obligations from:			FY 2008 (estimated)	FY 2008 Percentage of distributed total
		Previous authority	New authority	Total		
Alabama	64,182		74,295	74,295	74,295	1.47
Alaska	9,100		11,535	11,535	11,535	0.23
Arizona	107,366		127,859	127,859	127,859	2.54
Arkansas	43,796		49,308	49,308	49,308	0.98
California	646,682		790,789	790,789	790,789	15.69
Colorado	57,951		71,545	71,545	71,545	1.42
Connecticut	34,535		39,891	39,891	39,891	0.79
Delaware	9,045		11,058	11,058	11,058	0.22
District of Columbia	9,557		11,709	11,709	11,709	0.23
Florida	249,330		296,067	296,067	296,067	5.87
Georgia	129,458		165,874	165,874	165,874	3.29
Hawaii	12,404		15,314	15,314	15,314	0.30
Idaho	20,611		24,316	24,316	24,316	0.48
Illinois	225,395		209,767	209,767	209,767	4.16
Indiana	73,000		93,469	93,469	93,469	1.85
Iowa	33,096		36,230	36,230	36,230	0.72
Kansas	27,490		36,542	36,542	36,542	0.73
Kentucky	57,764		70,115	70,115	70,115	1.39
Louisiana	77,133		89,586	89,586	89,586	1.78
Maine	11,928		15,172	15,172	15,172	0.30
Maryland	62,419		66,961	66,961	66,961	1.33
Massachusetts	81,306		73,335	73,335	73,335	1.46
Michigan	117,165		149,383	149,383	149,383	2.96
Minnesota	46,515		48,613	48,613	48,613	0.96
Mississippi	123,498		60,495	60,495	60,495	1.20
Missouri	64,245		72,140	72,140	72,140	1.43
Montana	12,558		15,736	15,736	15,736	0.31
Nebraska	32,591		21,892	21,892	21,892	0.43
Nevada	41,896		52,056	52,056	52,056	1.03
New Hampshire	9,193		10,779	10,779	10,779	0.21
New Jersey	139,970		105,206	105,206	105,206	2.09
New Mexico	42,157		52,045	52,045	52,045	1.03
New York	272,452		340,807	340,807	340,807	6.76
North Carolina	113,067		136,117	136,117	136,117	2.70
North Dakota	6,346		7,738	7,738	7,738	0.15
Ohio	124,632		157,997	157,997	157,997	3.13
Oklahoma	57,371		70,828	70,828	70,828	1.41
Oregon	46,887		56,734	56,734	56,734	1.13
Pennsylvania	134,097		173,554	173,554	173,554	3.44
Rhode Island	33,619		13,983	13,983	13,983	0.28
South Carolina	55,545		70,651	70,651	70,651	1.40
South Dakota	8,372		10,354	10,354	10,354	0.21
Tennessee	80,407		97,460	97,460	97,460	1.93
Texas	454,742		557,980	557,980	557,980	11.07
Utah	32,208		40,486	40,486	40,486	0.80
Vermont	4,818		5,753	5,753	5,753	0.11
Virginia	72,303		94,070	94,070	94,070	1.87
Washington	64,706		79,883	79,883	79,883	1.58
West Virginia	23,350		27,517	27,517	27,517	0.55
Wisconsin	55,764		69,563	69,563	69,563	1.38
Wyoming	5,881		6,942	6,942	6,942	0.14
American Samoa	546		630	630	630	0.01
Guam	1,592		1,838	1,838	1,838	0.04
Northern Mariana Islands	501		578	578	578	0.01
Puerto Rico	41,675		48,090	48,090	48,090	0.95
Freely Associated States						
Virgin Islands	1,183		1,365	1,365	1,365	0.03
Indian Tribes						
Undistributed						
<b>Total</b>	<b>1 4,365,400</b>		<b>5,040,000</b>	<b>5,040,000</b>	<b>2 5,040,000</b>	<b>3 100.00</b>

<sup>1</sup> Includes \$283 million in shortfall funding from the Deficit Reduction Act.

<sup>2</sup> Assumes program receives reauthorization.

<sup>3</sup> Excludes undistributed obligations.

**Table 8-17. Grants to States for Medicaid (93.778)**

(Obligations in thousands of dollars)

State or Territory	FY 2006 Actual	Estimated FY 2007 obligations from:			FY 2008 (estimated)	FY 2008 Percentage of distributed total
		Previous authority	New authority	Total		
Alabama	2,811,355		2,806,831	2,806,831	2,819,149	1.36
Alaska	733,492		872,800	872,800	897,687	0.43
Arizona	4,436,368		4,662,315	4,662,315	5,114,866	2.47
Arkansas	2,304,017		2,444,471	2,444,471	2,661,730	1.29
California	21,931,980		20,818,937	20,818,937	21,560,850	10.42
Colorado	1,532,446		1,603,055	1,603,055	1,675,586	0.81
Connecticut	2,227,657		2,224,734	2,224,734	2,285,441	1.10
Delaware	515,728		545,539	545,539	592,470	0.29
District of Columbia	1,062,487		1,199,039	1,199,039	1,279,839	0.62
Florida	8,733,890		8,715,628	8,715,628	9,121,444	4.41
Georgia	4,744,732		4,541,194	4,541,194	4,955,788	2.40
Hawaii	728,625		643,587	643,587	657,414	0.32
Idaho	777,351		820,475	820,475	891,629	0.43
Illinois	5,993,277		5,775,493	5,775,493	6,168,570	2.98
Indiana	3,696,015		3,888,848	3,888,848	4,069,372	1.97
Iowa	1,754,671		1,717,644	1,717,644	1,829,478	0.88
Kansas	1,320,586		1,354,092	1,354,092	1,395,370	0.67
Kentucky	3,343,139		3,306,988	3,306,988	3,461,452	1.67
Louisiana	3,631,368		3,692,810	3,692,810	3,999,621	1.93
Maine	1,506,300		1,157,172	1,157,172	1,194,973	0.58
Maryland	2,929,314		2,952,992	2,952,992	3,116,243	1.51
Massachusetts	5,150,675		5,911,206	5,911,206	5,927,750	2.87
Michigan	5,206,747		5,336,206	5,336,206	5,162,765	2.50
Minnesota	3,079,537		3,168,233	3,168,233	3,577,872	1.73
Mississippi	2,810,880		2,696,873	2,696,873	2,970,793	1.44
Missouri	4,208,911		4,442,233	4,442,233	4,712,989	2.28
Montana	569,840		546,316	546,316	563,911	0.27
Nebraska	1,050,601		957,874	957,874	1,008,403	0.49
Nevada	719,691		671,157	671,157	671,000	0.32
New Hampshire	626,147		650,051	650,051	694,608	0.34
New Jersey	5,047,720		4,952,112	4,952,112	5,130,144	2.48
New Mexico	1,929,108		1,997,852	1,997,852	2,103,655	1.02
New York	24,223,095		25,020,102	25,020,102	24,961,924	12.07
North Carolina	6,206,828		6,528,916	6,528,916	7,831,399	3.79
North Dakota	354,268		366,542	366,542	386,256	0.19
Ohio	7,945,914		8,543,294	8,543,294	8,687,791	4.20
Oklahoma	2,199,646		2,662,883	2,662,883	2,732,840	1.32
Oregon	2,079,179		2,158,554	2,158,554	2,316,595	1.12
Pennsylvania	9,287,096		9,469,818	9,469,818	9,928,379	4.80
Rhode Island	1,004,539		974,072	974,072	1,056,158	0.51
South Carolina	2,986,972		2,898,600	2,898,600	2,853,534	1.38
South Dakota	430,904		431,162	431,162	430,179	0.21
Tennessee	4,825,494		4,594,265	4,594,265	4,629,530	2.24
Texas	11,431,765		12,634,509	12,634,509	13,023,608	6.30
Utah	1,167,263		1,119,241	1,119,241	1,192,293	0.58
Vermont	575,123		591,582	591,582	625,536	0.30
Virginia	2,529,202		2,726,856	2,726,856	2,943,719	1.42
Washington	3,240,127		3,197,092	3,197,092	3,281,008	1.59
West Virginia	1,658,639		1,779,241	1,779,241	1,899,449	0.92
Wisconsin	2,880,647		2,985,034	2,985,034	3,040,913	1.47
Wyoming	256,828		265,055	265,055	274,265	0.13
American Samoa	6,120		8,496	8,496	8,496	*
Guam	9,390		13,130	13,130	13,690	0.01
Northern Mariana Islands	3,467		4,662	4,662	4,662	*
Puerto Rico	241,017		286,222	286,222	286,222	0.14
Freely Associated States						
Virgin Islands	9,702		13,295	13,295	13,815	0.01
Indian Tribes						
Undistributed						
Survey & Certification	186,478		256,900	256,900	262,000	0.13
Fraud Control Units	161,600		174,800	174,800	183,540	0.09
Vaccines for Children	1,974,295		2,905,330	2,905,330	2,761,957	1.34
Medicare Part B Transfer	264,230		350,000	350,000		
Incurred But Not Reported	6,829,757		3,000,000	3,000,000	3,000,000	1.45
Adjustments	-241,804		-7,843,497	-7,843,497	-4,016,947	-1.94
<b>Total</b>	<b>201,842,436</b>		<b>195,190,913</b>	<b>195,190,913</b>	<b>206,885,673</b>	<b>1 100.00</b>

\* \$500 or less or 0.005 percent or less.

<sup>1</sup> Excludes undistributed obligations.

**Table 8-18. Temporary Assistance for Needy Families (TANF)—Family Assistance Grants (93.558)**

(Obligations in thousands of dollars)

State or Territory	FY 2006 Actual	Estimated FY 2007 obligations from:			FY 2008 (estimated)	FY 2008 Percentage of distributed total
		Previous authority	New authority	Total		
Alabama	123,072		104,408	104,408	104,408	0.61
Alaska	54,837		53,620	53,620	53,620	0.31
Arizona	226,449		226,131	226,131	226,131	1.33
Arkansas	63,117		62,951	62,951	62,951	0.37
California	3,669,879		3,665,160	3,665,160	3,665,160	21.49
Colorado	150,126		149,626	149,626	149,626	0.88
Connecticut	264,387		266,788	266,788	266,788	1.56
Delaware	31,411		32,291	32,291	32,291	0.19
District of Columbia	90,505		92,610	92,610	92,610	0.54
Florida	624,265		622,746	622,746	622,746	3.65
Georgia	374,208		368,025	368,025	368,025	2.16
Hawaii	98,905		98,905	98,905	98,905	0.58
Idaho	33,911		33,911	33,911	33,911	0.20
Illinois	585,057		585,057	585,057	585,057	3.43
Indiana	207,020		206,799	206,799	206,799	1.21
Iowa	131,525		130,994	130,994	130,994	0.77
Kansas	101,931		101,931	101,931	101,931	0.60
Kentucky	181,288		181,288	181,288	181,288	1.06
Louisiana	181,998		180,999	180,999	180,999	1.06
Maine	78,121		78,121	78,121	78,121	0.46
Maryland	228,194		229,098	229,098	229,098	1.34
Massachusetts	459,371		459,371	459,371	459,371	2.69
Michigan	776,207		775,353	775,353	775,353	4.55
Minnesota	263,548		263,434	263,434	263,434	1.54
Mississippi	100,142		95,803	95,803	95,803	0.56
Missouri	217,052		217,052	217,052	217,052	1.27
Montana	39,172		39,172	39,172	39,172	0.23
Nebraska	57,855		57,769	57,769	57,769	0.34
Nevada	46,637		47,641	47,641	47,641	0.28
New Hampshire	38,521		38,521	38,521	38,521	0.23
New Jersey	404,035		404,035	404,035	404,035	2.37
New Mexico	117,131		117,131	117,131	117,131	0.69
New York	2,443,135		2,442,931	2,442,931	2,442,931	14.32
North Carolina	338,350		338,350	338,350	338,350	1.98
North Dakota	26,400		26,400	26,400	26,400	0.15
Ohio	727,968		727,968	727,968	727,968	4.27
Oklahoma	147,594		147,594	147,594	147,594	0.87
Oregon	166,799		166,799	166,799	166,799	0.98
Pennsylvania	719,499		719,499	719,499	719,499	4.22
Rhode Island	95,104		95,022	95,022	95,022	0.56
South Carolina	119,961		99,968	99,968	99,968	0.59
South Dakota	21,280		21,280	21,280	21,280	0.12
Tennessee	251,394		213,089	213,089	213,089	1.25
Texas	551,999		538,965	538,965	538,965	3.16
Utah	84,349		84,314	84,314	84,314	0.49
Vermont	47,353		47,353	47,353	47,353	0.28
Virginia	158,442		158,285	158,285	158,285	0.93
Washington	382,854		382,854	382,854	382,854	2.24
West Virginia	109,185		110,176	110,176	110,176	0.65
Wisconsin	314,580		314,499	314,499	314,499	1.84
Wyoming	18,430		18,501	18,501	18,501	0.11
American Samoa						
Guam	2,599		3,465	3,465	3,465	0.02
Northern Mariana Islands						
Puerto Rico	71,562		71,563	71,563	71,563	0.42
Freely Associated States						
Virgin Islands	2,890		2,847	2,847	2,847	0.02
Indian Tribes	160,573		167,529	167,529	167,529	0.98
Undistributed						
Tribal New Program	7,558		7,633	7,633	7,633	0.04
Responsible Fatherhood	149,975		150,000	150,000	150,000	0.88
Territories Matching Fund			15,000	15,000	15,000	0.09
<b>Total<sup>1</sup></b>	<b><sup>2</sup> 17,139,710</b>		<b>17,058,625</b>	<b>17,058,625</b>	<b>17,058,625</b>	<b><sup>3</sup> 100.00</b>

<sup>1</sup> Unobligated contingency fund balances were \$1,900 million in 2006 and are estimated to be \$1,793 million in 2007 and \$1,703 million in 2008.

<sup>2</sup> Includes State Family Assistance Grants and Supplemental Population Growth Grants. For 2006, also includes \$107 million in Contingency funds.

<sup>3</sup> Excludes undistributed obligations.



**Table 8-19. Child Support Enforcement—Federal Share of State and Local Administrative Costs and Incentives (93.563)**

(Obligations in thousands of dollars)

State or Territory	FY 2006 Actual	Estimated FY 2007 obligations from:			FY 2008 (estimated)	FY 2008 Percentage of distributed total
		Previous authority	New authority	Total		
Alabama	42,365		44,452	44,452	39,637	1.00
Alaska	16,879		17,711	17,711	15,792	0.40
Arizona	48,888		51,296	51,296	45,739	1.15
Arkansas	31,758		33,322	33,322	29,713	0.75
California	795,581		834,765	834,765	744,340	18.78
Colorado	57,248		60,068	60,068	53,561	1.35
Connecticut	42,267		44,349	44,349	39,545	1.00
Delaware	20,373		21,376	21,376	19,060	0.48
District of Columbia	18,081		18,971	18,971	16,916	0.43
Florida	212,260		222,714	222,714	198,589	5.01
Georgia	83,222		87,321	87,321	77,862	1.96
Hawaii	14,539		15,255	15,255	13,603	0.34
Idaho	20,349		21,351	21,351	19,038	0.48
Illinois	116,701		122,448	122,448	109,184	2.76
Indiana	46,365		48,649	48,649	43,379	1.09
Iowa	41,034		43,055	43,055	38,391	0.97
Kansas	37,582		39,433	39,433	35,161	0.89
Kentucky	48,210		50,584	50,584	45,105	1.14
Louisiana	54,608		57,298	57,298	51,091	1.29
Maine	12,539		13,157	13,157	11,732	0.30
Maryland	65,615		68,847	68,847	61,389	1.55
Massachusetts	68,874		72,266	72,266	64,438	1.63
Michigan	199,793		209,633	209,633	186,925	4.72
Minnesota	106,479		111,723	111,723	99,621	2.51
Mississippi	18,695		19,616	19,616	17,491	0.44
Missouri	69,953		73,398	73,398	65,447	1.65
Montana	10,161		10,661	10,661	9,507	0.24
Nebraska	34,168		35,851	35,851	31,967	0.81
Nevada	29,869		31,341	31,341	27,946	0.71
New Hampshire	14,543		15,259	15,259	13,606	0.34
New Jersey	172,482		180,977	180,977	161,373	4.07
New Mexico	27,776		29,144	29,144	25,987	0.66
New York	243,896		255,908	255,908	228,187	5.76
North Carolina	101,518		106,518	106,518	94,980	2.40
North Dakota	9,382		9,844	9,844	8,778	0.22
Ohio	240,706		252,561	252,561	225,203	5.68
Oklahoma	41,393		43,431	43,431	38,727	0.98
Oregon	43,159		45,285	45,285	40,379	1.02
Pennsylvania	192,854		202,352	202,352	180,433	4.55
Rhode Island	8,004		8,398	8,398	7,488	0.19
South Carolina	29,500		30,953	30,953	27,600	0.70
South Dakota	6,903		7,243	7,243	6,458	0.16
Tennessee	54,725		57,420	57,420	51,200	1.29
Texas	226,374		237,523	237,523	211,793	5.34
Utah	31,737		33,300	33,300	29,693	0.75
Vermont	8,161		8,563	8,563	7,635	0.19
Virginia	72,485		76,055	76,055	67,816	1.71
Washington	109,443		114,833	114,833	102,394	2.58
West Virginia	23,103		24,241	24,241	21,615	0.55
Wisconsin	99,816		104,732	104,732	93,387	2.36
Wyoming	6,663		6,992	6,992	6,234	0.16
American Samoa						
Guam	4,271		4,481	4,481	3,996	0.10
Northern Mariana Islands						
Puerto Rico	41,585		43,633	43,633	38,907	0.98
Freely Associated States						
Virgin Islands	3,928		4,121	4,121	3,675	0.09
Indian Tribes	17,665		30,000	30,000	53,000	1.34
Undistributed						
<b>Total</b>	<b>4,196,528</b>		<b>4,414,678</b>	<b>4,414,678</b>	<b>3,962,713</b>	<b>1 100.00</b>

<sup>1</sup> Excludes undistributed obligations.

**Table 8-20. Low Income Home Energy Assistance Program (93.568)**

(Obligations in thousands of dollars)

State or Territory	FY 2006 Actual	Estimated FY 2007 obligations from:			FY 2008 (estimated)	FY 2008 Percentage of distributed total
		Previous authority	New authority	Total		
Alabama	31,129		16,673	16,673	12,574	0.84
Alaska	8,738		7,418	7,418	5,594	0.37
Arizona	13,994		7,448	7,448	5,617	0.37
Arkansas	22,765		12,796	12,796	9,650	0.64
California	152,030		89,199	89,199	67,269	4.48
Colorado	31,704		31,334	31,334	23,631	1.58
Connecticut	47,809		40,920	40,920	30,860	2.06
Delaware	10,141		5,431	5,431	4,096	0.27
District of Columbia	7,852		6,355	6,355	4,793	0.32
Florida	49,529		26,527	26,527	20,006	1.33
Georgia	39,170		20,979	20,979	15,822	1.05
Hawaii	2,555		2,113	2,113	1,593	0.11
Idaho	13,673		11,642	11,642	8,780	0.59
Illinois	145,959		113,259	113,259	85,415	5.69
Indiana	53,980		51,272	51,272	38,667	2.58
Iowa	36,762		36,343	36,343	27,409	1.83
Kansas	26,786		16,675	16,675	12,576	0.84
Kentucky	44,347		26,686	26,686	20,126	1.34
Louisiana	32,010		17,144	17,144	12,929	0.86
Maine	25,835		25,541	25,541	19,262	1.28
Maryland	58,499		31,332	31,332	23,629	1.58
Massachusetts	82,764		81,820	81,820	61,706	4.11
Michigan	108,028		106,543	106,543	80,351	5.36
Minnesota	78,363		77,469	77,469	58,424	3.89
Mississippi	26,793		14,350	14,350	10,822	0.72
Missouri	59,541		45,240	45,240	34,118	2.27
Montana	14,224		11,843	11,843	8,931	0.60
Nebraska	21,102		17,961	17,961	13,546	0.90
Nevada	7,112		3,809	3,809	2,873	0.19
New Hampshire	18,197		15,493	15,493	11,684	0.78
New Jersey	77,346		75,798	75,798	57,164	3.81
New Mexico	11,031		9,358	9,358	7,058	0.47
New York	250,543		247,980	247,980	187,016	12.47
North Carolina	67,810		36,319	36,319	27,390	1.83
North Dakota	14,298		12,753	12,753	9,617	0.64
Ohio	122,259		100,195	100,195	75,563	5.04
Oklahoma	26,228		13,991	13,991	10,552	0.70
Oregon	24,059		23,614	23,614	17,809	1.19
Pennsylvania	134,810		133,273	133,273	100,509	6.70
Rhode Island	15,780		13,435	13,435	10,132	0.68
South Carolina	24,867		13,318	13,318	10,044	0.67
South Dakota	12,227		10,410	10,410	7,851	0.52
Tennessee	46,363		27,033	27,033	20,387	1.36
Texas	82,421		44,144	44,144	33,292	2.22
Utah	16,806		14,233	14,233	10,734	0.72
Vermont	13,639		11,613	11,613	8,758	0.58
Virginia	71,259		38,166	38,166	28,783	1.92
Washington	38,885		38,355	38,355	28,925	1.93
West Virginia	23,818		17,660	17,660	13,319	0.89
Wisconsin	70,538		69,733	69,733	52,590	3.51
Wyoming	6,644		5,558	5,558	4,191	0.28
American Samoa	55		44	44	33	*
Guam	120		95	95	72	*
Northern Mariana Islands	42		33	33	25	*
Puerto Rico	2,990		2,381	2,381	1,795	0.12
Freely Associated States						
Virgin Islands	114		91	91	68	*
Indian Tribes	26,135		21,280	21,280	16,048	1.07
Undistributed						
Discretionary Funds	26,953		27,225	27,225	27,225	1.82
Technical Assistance	294		297	297	297	0.02
<b>Total</b>	<b>2,479,725</b>		<b>1,980,000</b>	<b>1,980,000</b>	<b>1,500,000</b>	<b>1 100.00</b>

\* \$500 or less or 0.005 percent or less.

<sup>1</sup> Excludes undistributed obligations.

**Table 8-21. Child Care and Development Block Grant (93.575)**

(Obligations in thousands of dollars)

State or Territory	FY 2006 Actual	Estimated FY 2007 obligations from:			FY 2008 (estimated)	FY 2008 Percentage of distributed total
		Previous authority	New authority	Total		
Alabama	40,558		40,166	40,166	40,166	1.95
Alaska	4,031		4,037	4,037	4,037	0.20
Arizona	49,967		50,263	50,263	50,263	2.44
Arkansas	24,681		25,039	25,039	25,039	1.21
California	228,983		230,818	230,818	230,818	11.19
Colorado	23,735		23,885	23,885	23,885	1.16
Connecticut	14,304		14,330	14,330	14,330	0.69
Delaware	4,526		4,408	4,408	4,408	0.21
District of Columbia	3,096		3,057	3,057	3,057	0.15
Florida	114,828		114,080	114,080	114,080	5.53
Georgia	75,686		77,908	77,908	77,908	3.78
Hawaii	8,099		7,737	7,737	7,737	0.38
Idaho	11,585		11,574	11,574	11,574	0.56
Illinois	75,951		76,663	76,663	76,663	3.72
Indiana	41,403		41,684	41,684	41,684	2.02
Iowa	18,217		17,763	17,763	17,763	0.86
Kansas	18,822		18,656	18,656	18,656	0.90
Kentucky	35,437		35,306	35,306	35,306	1.71
Louisiana	46,991		45,956	45,956	45,956	2.23
Maine	6,852		6,705	6,705	6,705	0.33
Maryland	26,266		25,531	25,531	25,531	1.24
Massachusetts	25,610		25,589	25,589	25,589	1.24
Michigan	58,711		58,069	58,069	58,069	2.82
Minnesota	25,797		25,584	25,584	25,584	1.24
Mississippi	32,277		31,879	31,879	31,879	1.55
Missouri	38,877		38,680	38,680	38,680	1.88
Montana	5,699		5,650	5,650	5,650	0.27
Nebraska	11,885		11,506	11,506	11,506	0.56
Nevada	13,529		14,087	14,087	14,087	0.68
New Hampshire	4,722		4,714	4,714	4,714	0.23
New Jersey	36,865		36,730	36,730	36,730	1.78
New Mexico	18,519		18,306	18,306	18,306	0.89
New York	107,464		107,664	107,664	107,664	5.22
North Carolina	65,036		66,549	66,549	66,549	3.23
North Dakota	3,832		3,645	3,645	3,645	0.18
Ohio	67,666		67,281	67,281	67,281	3.26
Oklahoma	31,231		31,057	31,057	31,057	1.51
Oregon	22,319		22,465	22,465	22,465	1.09
Pennsylvania	62,745		62,629	62,629	62,629	3.04
Rhode Island	5,809		5,497	5,497	5,497	0.27
South Carolina	37,046		36,946	36,946	36,946	1.79
South Dakota	5,724		5,416	5,416	5,416	0.26
Tennessee	45,097		44,427	44,427	44,427	2.15
Texas	210,925		216,109	216,109	216,109	10.48
Utah	22,353		22,349	22,349	22,349	1.08
Vermont	2,946		2,898	2,898	2,898	0.14
Virginia	39,823		38,903	38,903	38,903	1.89
Washington	32,997		33,070	33,070	33,070	1.60
West Virginia	13,678		13,550	13,550	13,550	0.66
Wisconsin	29,774		29,631	29,631	29,631	1.44
Wyoming	2,803		2,694	2,694	2,694	0.13
American Samoa	2,681		2,679	2,679	2,679	0.13
Guam	4,064		4,061	4,061	4,061	0.20
Northern Mariana Islands	1,700		1,722	1,722	1,722	0.08
Puerto Rico	38,244		35,432	35,432	35,432	1.72
Freely Associated States						
Virgin Islands	1,866		1,847	1,847	1,847	0.09
Indian Tribes	41,242		41,242	41,242	41,242	2.00
Undistributed						
Technical Assistance	4,587		5,155	5,155	5,155	0.25
Research Set-Aside	9,521		9,821	9,821	9,821	0.48
Child Care Aware	982		982	982	982	0.05
<b>Total</b>	<b>2,060,664</b>		<b>2,062,081</b>	<b>2,062,081</b>	<b>2,062,081</b>	<b>100.00</b>

<sup>1</sup> Excludes undistributed obligations.

**Table 8-22. Child Care and Development Fund—Mandatory (93.596a)**

(Obligations in thousands of dollars)

State or Territory	FY 2006 Actual	Estimated FY 2007 obligations from:			FY 2008 (estimated)	FY 2008 Percentage of distributed total
		Previous authority	New authority	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	85,590		85,590	85,590	85,590	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	101,984		101,984	101,984	101,984	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	58,340		58,340	58,340	58,340	4.71
Undistributed						
Technical Assistance	3,792		3,792	3,792	3,792	0.31
<b>Total</b>	<b>1,239,657</b>		<b>1,239,657</b>	<b>1,239,657</b>	<b>1,239,657</b>	<b>100.00</b>

<sup>1</sup> Excludes undistributed obligations.

**Table 8-23. Child Care and Development Fund—Matching (93.596b)**

(Obligations in thousands of dollars)

State or Territory	FY 2006 Actual	Estimated FY 2007 obligations from:			FY 2008 (estimated)	FY 2008 Percentage of distributed total
		Previous authority	New authority	Total		
Alabama	24,871		24,871	24,871	24,871	1.48
Alaska	4,204		4,196	4,196	4,196	0.25
Arizona	36,239		36,179	36,179	36,179	2.16
Arkansas	15,462		15,435	15,435	15,435	0.92
California	221,412		221,032	221,032	221,032	13.18
Colorado	27,340		27,294	27,294	27,294	1.63
Connecticut	18,943		18,908	18,908	18,908	1.13
Delaware	4,420		4,413	4,413	4,413	0.26
District of Columbia	2,627		2,622	2,622	2,622	0.16
Florida	91,116		90,962	90,962	90,962	5.42
Georgia	54,242		54,150	54,150	54,150	3.23
Hawaii	6,918		6,906	6,906	6,906	0.41
Idaho	8,522		8,507	8,507	8,507	0.51
Illinois	74,674		74,544	74,544	74,544	4.44
Indiana	36,702		36,639	36,639	36,639	2.18
Iowa	15,328		15,300	15,300	15,300	0.91
Kansas	15,603		15,576	15,576	15,576	0.93
Kentucky	22,416		22,416	22,416	22,416	1.34
Louisiana	26,556		26,556	26,556	26,556	1.58
Maine	6,100		6,089	6,089	6,089	0.36
Maryland	31,566		31,566	31,566	31,566	1.88
Massachusetts	33,274		33,216	33,216	33,216	1.98
Michigan	57,026		56,925	56,925	56,925	3.39
Minnesota	27,941		27,892	27,892	27,892	1.66
Mississippi	17,173		17,143	17,143	17,143	1.02
Missouri	31,311		31,256	31,256	31,256	1.86
Montana	4,548		4,539	4,539	4,539	0.27
Nebraska	9,917		9,900	9,900	9,900	0.59
Nevada	14,146		14,123	14,123	14,123	0.84
New Hampshire	6,685		6,673	6,673	6,673	0.40
New Jersey	49,429		49,344	49,344	49,344	2.94
New Mexico	11,122		11,102	11,102	11,102	0.66
New York	104,303		104,120	104,120	104,120	6.21
North Carolina	49,039		48,955	48,955	48,955	2.92
North Dakota	3,072		3,066	3,066	3,066	0.18
Ohio	62,884		62,770	62,770	62,770	3.74
Oklahoma	19,718		19,683	19,683	19,683	1.17
Oregon	19,355		19,321	19,321	19,321	1.15
Pennsylvania	63,075		62,964	62,964	62,964	3.75
Rhode Island	5,467		5,458	5,458	5,458	0.33
South Carolina	23,271		23,232	23,232	23,232	1.39
South Dakota	4,289		4,282	4,282	4,282	0.26
Tennessee	31,862		31,806	31,806	31,806	1.90
Texas	146,569		146,323	146,323	146,323	8.72
Utah	17,634		17,634	17,634	17,634	1.05
Vermont	2,885		2,880	2,880	2,880	0.17
Virginia	41,312		41,242	41,242	41,242	2.46
Washington	33,507		33,507	33,507	33,507	2.00
West Virginia	8,648		8,633	8,633	8,633	0.51
Wisconsin	29,166		29,114	29,114	29,114	1.74
Wyoming	2,578		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	3,501		3,501	3,501	3,501	0.21
<b>Total</b>	<b>1,679,968</b>		<b>1,677,343</b>	<b>1,677,343</b>	<b>1,677,343</b>	<b>2 100.00</b>

<sup>1</sup> Includes reappropriated funds from prior year.

<sup>2</sup> Excludes undistributed obligations.

**Table 8-24. Head Start (93.600)**

(Obligations in thousands of dollars)

State or Territory	FY 2006 Actual	Estimated FY 2007 obligations from:			FY 2008 (estimated)	FY 2008 Percentage of distributed total
		Previous authority	New authority	Total		
Alabama	105,468		105,468	105,468	105,468	1.55
Alaska	12,337		12,337	12,337	12,337	0.18
Arizona	102,373		102,373	102,373	102,373	1.51
Arkansas	63,824		63,824	63,824	63,824	0.94
California	822,591		822,591	822,591	822,591	12.12
Colorado	67,594		67,594	67,594	67,594	1.00
Connecticut	51,333		51,333	51,333	51,333	0.76
Delaware	13,092		13,092	13,092	13,092	0.19
District of Columbia	24,834		24,834	24,834	24,834	0.37
Florida	260,267		260,267	260,267	260,267	3.83
Georgia	166,672		166,672	166,672	166,672	2.46
Hawaii	22,637		22,637	22,637	22,637	0.33
Idaho	22,565		22,565	22,565	22,565	0.33
Illinois	267,812		267,812	267,812	267,812	3.95
Indiana	95,151		95,151	95,151	95,151	1.40
Iowa	50,988		50,988	50,988	50,988	0.75
Kansas	50,372		50,372	50,372	50,372	0.74
Kentucky	106,670		106,670	106,670	106,670	1.57
Louisiana	144,312		144,312	144,312	144,312	2.13
Maine	27,310		27,310	27,310	27,310	0.40
Maryland	77,184		77,184	77,184	77,184	1.14
Massachusetts	107,169		107,169	107,169	107,169	1.58
Michigan	231,993		231,993	231,993	231,993	3.42
Minnesota	71,219		71,219	71,219	71,219	1.05
Mississippi	159,927		159,927	159,927	159,927	2.36
Missouri	117,695		117,695	117,695	117,695	1.73
Montana	20,721		20,721	20,721	20,721	0.31
Nebraska	35,665		35,665	35,665	35,665	0.53
Nevada	24,015		24,015	24,015	24,015	0.35
New Hampshire	13,240		13,240	13,240	13,240	0.20
New Jersey	127,607		127,607	127,607	127,607	1.88
New Mexico	51,730		51,730	51,730	51,730	0.76
New York	428,470		428,470	428,470	428,470	6.31
North Carolina	139,735		139,735	139,735	139,735	2.06
North Dakota	16,988		16,988	16,988	16,988	0.25
Ohio	244,205		244,205	244,205	244,205	3.60
Oklahoma	80,166		80,166	80,166	80,166	1.18
Oregon	58,821		58,821	58,821	58,821	0.87
Pennsylvania	225,685		225,685	225,685	225,685	3.32
Rhode Island	21,775		21,775	21,775	21,775	0.32
South Carolina	81,603		81,603	81,603	81,603	1.20
South Dakota	18,620		18,620	18,620	18,620	0.27
Tennessee	118,039		118,039	118,039	118,039	1.74
Texas	473,492		473,492	473,492	473,492	6.97
Utah	37,353		37,353	37,353	37,353	0.55
Vermont	13,412		13,412	13,412	13,412	0.20
Virginia	98,018		98,018	98,018	98,018	1.44
Washington	99,268		99,268	99,268	99,268	1.46
West Virginia	50,091		50,091	50,091	50,091	0.74
Wisconsin	89,887		89,887	89,887	89,887	1.32
Wyoming	12,236		12,236	12,236	12,236	0.18
American Samoa	2,127		2,127	2,127	2,127	0.03
Guam	2,140		2,140	2,140	2,140	0.03
Northern Mariana Islands	1,646		1,646	1,646	1,646	0.02
Puerto Rico	246,599		246,599	246,599	246,599	3.63
Freely Associated States						
Virgin Islands	7,910		7,910	7,910	7,910	0.12
Indian Tribes	185,394		185,394	185,394	185,394	2.73
Undistributed						
Palau	1,319		1,319	1,319	1,319	0.02
Migrant Program	283,371		283,371	283,371	283,371	4.17
Unallocated Expansion			70,629	70,629	70,629	1.04
Technical Assistance	164,057		104,815	104,815	104,815	1.54
Research, Development, & Education	19,788		19,800	19,800	19,800	0.29
Program Support	38,202		38,590	38,590	38,590	0.57
Hurricane Relief	73,999					
<b>Total</b>	<b>6,850,783</b>		<b>6,788,571</b>	<b>6,788,571</b>	<b>6,788,571</b>	<b>100.00</b>

<sup>1</sup> Excludes undistributed obligations.

**Table 8-25. Foster Care—Title IV-E (93.658)**

(Obligations in thousands of dollars)

State or Territory	FY 2006 Actual	Estimated FY 2007 obligations from:			FY 2008 (estimated)	FY 2008 Percentage of distributed total
		Previous authority	New authority	Total		
Alabama	18,616		19,252	19,252	19,703	0.43
Alaska	16,010		16,557	16,557	16,945	0.37
Arizona	94,357		97,580	97,580	99,867	2.17
Arkansas	31,578		32,657	32,657	33,422	0.73
California	1,183,911		1,224,363	1,224,363	1,253,059	27.28
Colorado	61,416		63,514	63,514	65,003	1.42
Connecticut	82,984		85,820	85,820	87,831	1.91
Delaware	6,157		6,367	6,367	6,516	0.14
District of Columbia	9,363		9,683	9,683	9,909	0.22
Florida	144,204		149,131	149,131	152,626	3.32
Georgia	31,631		32,712	32,712	33,478	0.73
Hawaii	23,637		24,445	24,445	25,018	0.54
Idaho	8,907		9,212	9,212	9,428	0.21
Illinois	213,896		221,204	221,204	226,388	4.93
Indiana	99,023		102,406	102,406	104,806	2.28
Iowa	26,704		27,617	27,617	28,264	0.62
Kansas	29,911		30,933	30,933	31,658	0.69
Kentucky	54,155		56,005	56,005	57,318	1.25
Louisiana	55,643		57,544	57,544	58,893	1.28
Maine	8,149		8,427	8,427	8,624	0.19
Maryland	121,066		125,202	125,202	128,136	2.79
Massachusetts	68,972		71,329	71,329	73,000	1.59
Michigan	91,435		94,559	94,559	96,775	2.11
Minnesota	58,689		60,694	60,694	62,116	1.35
Mississippi	7,925		8,196	8,196	8,388	0.18
Missouri	57,235		59,191	59,191	60,578	1.32
Montana	12,864		13,303	13,303	13,615	0.30
Nebraska	14,470		14,964	14,964	15,315	0.33
Nevada	21,183		21,907	21,907	22,420	0.49
New Hampshire	16,913		17,491	17,491	17,901	0.39
New Jersey	54,992		56,870	56,870	58,203	1.27
New Mexico	20,872		21,585	21,585	22,091	0.48
New York	342,991		354,710	354,710	363,022	7.90
North Carolina	84,336		87,218	87,218	89,262	1.94
North Dakota	9,751		10,084	10,084	10,320	0.22
Ohio	201,789		208,683	208,683	213,574	4.65
Oklahoma	42,358		43,805	43,805	44,832	0.98
Oregon	55,539		57,437	57,437	58,783	1.28
Pennsylvania	220,820		228,365	228,365	233,717	5.09
Rhode Island	13,014		13,459	13,459	13,774	0.30
South Carolina	10,622		10,985	10,985	11,243	0.24
South Dakota	5,592		5,783	5,783	5,918	0.13
Tennessee	40,841		42,236	42,236	43,226	0.94
Texas	212,079		219,325	219,325	224,466	4.89
Utah	23,033		23,820	23,820	24,378	0.53
Vermont	11,452		11,843	11,843	12,121	0.26
Virginia	78,547		81,231	81,231	83,135	1.81
Washington	78,829		81,522	81,522	83,432	1.82
West Virginia	12,715		13,149	13,149	13,457	0.29
Wisconsin	84,861		87,761	87,761	89,818	1.96
Wyoming	3,080		3,185	3,185	3,260	0.07
American Samoa						
Guam						
Northern Mariana Islands						
Puerto Rico	37,195		38,466	38,466	39,367	0.86
Freely Associated States						
Virgin Islands						
Indian Tribes						
Undistributed						
Technical Assistance	9,051		11,213	11,213	15,601	0.34
New Program Option					9,000	0.20
<b>Total</b>	<b>4,325,363</b>		<b>1 4,475,000</b>	<b>4,475,000</b>	<b>4,593,000</b>	<b>2 100.00</b>

<sup>1</sup> Assumes a lapse of \$282 million.

<sup>2</sup> Excludes undistributed obligations.

**Table 8-26. Adoption Assistance (93.659)**

(Obligations in thousands of dollars)

State or Territory	FY 2006 Actual	Estimated FY 2007 obligations from:			FY 2008 (estimated)	FY 2008 Percentage of distributed total
		Previous authority	New authority	Total		
Alabama	7,812		8,839	8,839	9,414	0.44
Alaska	7,283		8,241	8,241	8,778	0.41
Arizona	37,146		42,030	42,030	44,767	2.07
Arkansas	10,132		11,464	11,464	12,210	0.57
California	313,126		354,296	354,296	377,372	17.48
Colorado	19,941		22,563	22,563	24,032	1.11
Connecticut	24,854		28,122	28,122	29,953	1.39
Delaware	1,605		1,816	1,816	1,934	0.09
District of Columbia	11,621		13,149	13,149	14,005	0.65
Florida	60,960		68,975	68,975	73,467	3.40
Georgia	34,751		39,320	39,320	41,880	1.94
Hawaii	11,221		12,697	12,697	13,524	0.63
Idaho	3,369		3,812	3,812	4,060	0.19
Illinois	88,696		100,357	100,357	106,893	4.95
Indiana	36,956		41,815	41,815	44,538	2.06
Iowa	21,852		24,725	24,725	26,335	1.22
Kansas	13,084		14,804	14,804	15,769	0.73
Kentucky	24,766		28,022	28,022	29,847	1.38
Louisiana	13,507		15,283	15,283	16,278	0.75
Maine	8,318		9,412	9,412	10,024	0.46
Maryland	19,671		22,257	22,257	23,706	1.10
Massachusetts	28,982		32,793	32,793	34,928	1.62
Michigan	113,110		127,982	127,982	136,316	6.31
Minnesota	22,009		24,903	24,903	26,525	1.23
Mississippi	4,284		4,847	4,847	5,163	0.24
Missouri	36,222		40,984	40,984	43,653	2.02
Montana	7,437		8,415	8,415	8,963	0.42
Nebraska	7,035		7,960	7,960	8,479	0.39
Nevada	6,573		7,437	7,437	7,922	0.37
New Hampshire	3,571		4,041	4,041	4,304	0.20
New Jersey	31,676		35,840	35,840	38,174	1.77
New Mexico	11,677		13,212	13,212	14,072	0.65
New York	211,357		239,146	239,146	254,719	11.80
North Carolina	28,654		32,422	32,422	34,533	1.60
North Dakota	3,397		3,843	3,843	4,094	0.19
Ohio	146,037		165,238	165,238	175,998	8.15
Oklahoma	28,611		32,373	32,373	34,481	1.60
Oregon	30,402		34,399	34,399	36,639	1.70
Pennsylvania	73,207		82,832	82,832	88,226	4.09
Rhode Island	9,409		10,646	10,646	11,339	0.53
South Carolina	13,004		14,714	14,714	15,672	0.73
South Dakota	2,706		3,062	3,062	3,261	0.15
Tennessee	29,991		33,934	33,934	36,144	1.67
Texas	58,296		65,960	65,960	70,256	3.25
Utah	6,826		7,724	7,724	8,226	0.38
Vermont	5,678		6,425	6,425	6,843	0.32
Virginia	14,197		16,064	16,064	17,110	0.79
Washington	34,314		38,825	38,825	41,353	1.92
West Virginia	10,741		12,153	12,153	12,945	0.60
Wisconsin	39,670		44,885	44,885	47,808	2.21
Wyoming	850		962	962	1,025	0.05
American Samoa						
Guam						
Northern Mariana Islands						
Puerto Rico	866		980	980	1,043	0.05
Freely Associated States						
Virgin Islands						
Indian Tribes						
Undistributed						
<b>Total</b>	<b>1,791,460</b>		<b>1 2,027,000</b>	<b>2,027,000</b>	<b>2,159,000</b>	<b>2 100.00</b>

<sup>1</sup> Assumes a lapse of \$17 million.  
<sup>2</sup> Excludes undistributed obligations.



**Table 8-27. Social Services Block Grant (93.667)**

(Obligations in thousands of dollars)

State or Territory	FY 2006 Actual	Estimated FY 2007 obligations from:			FY 2008 (estimated)	FY 2008 Percentage of distributed total
		Previous authority	New authority	Total		
Alabama	26,163		26,163	26,163	18,468	1.54
Alaska	3,772		3,772	3,772	2,662	0.22
Arizona	32,442		32,442	32,442	22,900	1.91
Arkansas	15,845		15,845	15,845	11,185	0.93
California	206,275		206,275	206,275	145,607	12.13
Colorado	26,454		26,454	26,454	18,673	1.56
Connecticut	20,249		20,249	20,249	14,294	1.19
Delaware	4,752		4,752	4,752	3,354	0.28
District of Columbia	3,275		3,275	3,275	2,312	0.19
Florida	98,934		98,934	98,934	69,836	5.82
Georgia	50,485		50,485	50,485	35,637	2.97
Hawaii	7,311		7,311	7,311	5,160	0.43
Idaho	7,943		7,943	7,943	5,607	0.47
Illinois	73,557		73,557	73,557	51,922	4.33
Indiana	36,016		36,016	36,016	25,423	2.12
Iowa	17,114		17,114	17,114	12,081	1.01
Kansas	15,832		15,832	15,832	11,176	0.93
Kentucky	23,937		23,937	23,937	16,897	1.41
Louisiana	26,138		26,138	26,138	18,450	1.54
Maine	7,590		7,590	7,590	5,358	0.45
Maryland	32,024		32,024	32,024	22,605	1.88
Massachusetts	37,398		37,398	37,398	26,399	2.20
Michigan	58,596		58,596	58,596	41,362	3.45
Minnesota	29,411		29,411	29,411	20,761	1.73
Mississippi	16,749		16,749	16,749	11,823	0.99
Missouri	33,161		33,161	33,161	23,408	1.95
Montana	5,334		5,334	5,334	3,765	0.31
Nebraska	10,111		10,111	10,111	7,137	0.59
Nevada	13,028		13,028	13,028	9,196	0.77
New Hampshire	7,485		7,485	7,485	5,284	0.44
New Jersey	50,216		50,216	50,216	35,447	2.95
New Mexico	10,897		10,897	10,897	7,692	0.64
New York	111,555		111,555	111,555	78,744	6.56
North Carolina	48,872		48,872	48,872	34,498	2.87
North Dakota	3,685		3,685	3,685	2,601	0.22
Ohio	66,478		66,478	66,478	46,925	3.91
Oklahoma	20,413		20,413	20,413	14,409	1.20
Oregon	20,692		20,692	20,692	14,606	1.22
Pennsylvania	71,882		71,882	71,882	50,740	4.23
Rhode Island	6,256		6,256	6,256	4,416	0.37
South Carolina	24,108		24,108	24,108	17,017	1.42
South Dakota	4,443		4,443	4,443	3,136	0.26
Tennessee	33,959		33,959	33,959	23,971	2.00
Texas	128,578		128,578	128,578	90,761	7.56
Utah	13,669		13,669	13,669	9,649	0.80
Vermont	3,599		3,599	3,599	2,540	0.21
Virginia	42,938		42,938	42,938	30,309	2.53
Washington	35,643		35,643	35,643	25,160	2.10
West Virginia	10,524		10,524	10,524	7,429	0.62
Wisconsin	31,811		31,811	31,811	22,455	1.87
Wyoming	2,914		2,914	2,914	2,057	0.17
American Samoa	49		49	49	34	*
Guam	293		293	293	207	0.02
Northern Mariana Islands	59		59	59	41	*
Puerto Rico	8,793		8,793	8,793	6,207	0.52
Freely Associated States						
Virgin Islands	293		293	293	207	0.02
Indian Tribes						
Undistributed						
Hurricane Relief	550,000					
<b>Total</b>	<b>2,250,000</b>		<b>1,700,000</b>	<b>1,700,000</b>	<b>1,200,000</b>	<b>1 100.00</b>

\* \$500 or less or 0.005 percent or less.

<sup>1</sup> Excludes undistributed obligations.

**Table 8-28. Homeland Security Grant Program (97.067)**

(Obligations in thousands of dollars)

State or Territory	FY 2006 Actual	Estimated FY 2007 obligations from:			FY 2008 (estimated)	FY 2008 Percentage of distributed total
		Previous authority	New authority	Total		
Alabama	18,916		11,824	11,824	4,495	1.70
Alaska	11,047		9,252	9,252	2,923	1.10
Arizona	24,351		13,557	13,557	4,892	1.85
Arkansas	11,036		10,101	10,101	3,768	1.42
California	271,002		54,027	54,027	17,029	6.42
Colorado	25,386		10,807	10,807	4,503	1.70
Connecticut	16,297		10,449	10,449	4,075	1.54
Delaware	12,108		8,802	8,802	2,990	1.13
District of Columbia	70,419		28,106	28,106	2,893	1.09
Florida	111,003		19,376	19,376	9,498	3.58
Georgia	51,572		16,688	16,688	6,162	2.32
Hawaii	14,957		9,283	9,283	3,169	1.20
Idaho	13,765		9,067	9,067	3,208	1.21
Illinois	110,894		28,116	28,116	7,815	2.95
Indiana	25,264		12,599	12,599	5,180	1.95
Iowa	16,066		9,811	9,811	3,861	1.46
Kansas	16,969		10,167	10,167	3,771	1.42
Kentucky	27,503		11,333	11,333	4,334	1.63
Louisiana	36,320		14,457	14,457	4,494	1.70
Maine	9,774		8,853	8,853	3,189	1.20
Maryland	28,360		11,466	11,466	4,893	1.85
Massachusetts	58,046		28,197	28,197	5,290	2.00
Michigan	54,702		14,321	14,321	6,772	2.55
Minnesota	17,631		11,729	11,729	4,713	1.78
Mississippi	11,091		9,784	9,784	3,834	1.45
Missouri	48,163		12,200	12,200	4,981	1.88
Montana	9,779		8,689	8,689	3,031	1.14
Nebraska	23,893		9,747	9,747	3,367	1.27
Nevada	23,917		9,684	9,684	3,549	1.34
New Hampshire	9,869		9,296	9,296	3,181	1.20
New Jersey	57,947		13,828	13,828	6,175	2.33
New Mexico	10,463		9,159	9,159	3,418	1.29
New York	252,532		84,520	84,520	10,499	3.96
North Carolina	35,216		13,637	13,637	6,064	2.29
North Dakota	12,848		8,379	8,379	2,919	1.10
Ohio	49,537		16,834	16,834	7,333	2.77
Oklahoma	22,285		10,500	10,500	4,089	1.54
Oregon	21,704		10,063	10,063	4,100	1.55
Pennsylvania	67,203		25,240	25,240	7,707	2.91
Rhode Island	9,745		9,515	9,515	3,097	1.17
South Carolina	18,258		10,890	10,890	4,340	1.64
South Dakota	9,840		8,433	8,433	2,971	1.12
Tennessee	18,144		13,463	13,463	5,031	1.90
Texas	102,194		24,182	24,182	11,571	4.36
Utah	10,821		9,935	9,935	3,607	1.36
Vermont	12,651		8,371	8,371	2,912	1.10
Virginia	21,814		13,777	13,777	5,644	2.13
Washington	40,445		14,452	14,452	5,143	1.94
West Virginia	15,467		9,376	9,376	3,397	1.28
Wisconsin	27,927		11,330	11,330	4,886	1.84
Wyoming	9,373		8,514	8,514	2,863	1.08
American Samoa	5,159		2,727	2,727	1,685	0.64
Guam	3,337		2,882	2,882	1,842	0.69
Northern Mariana Islands	3,203		2,709	2,709	1,706	0.64
Puerto Rico	10,645		9,946	9,946	4,238	1.60
Freely Associated States	102		150	150	115	0.04
Virgin Islands	3,579		2,929	2,929	1,892	0.71
Indian Tribes						
Undistributed						
<b>Total</b>	<b>2,032,541</b>		<b>787,530</b>	<b>1,787,530</b>	<b>1,265,100</b>	<b>2,100.00</b>

<sup>1</sup> FY 2007-2008 amounts do not include funds subject to risk and threat analysis.

<sup>2</sup> Excludes undistributed obligations.

**Table 8-29. Disaster Grants—Public Assistance (Presidentially Declared Disasters) (97.036)**

(Obligations in thousands of dollars)

State or Territory	FY 2006 Actual	Estimated FY 2007 obligations from:			FY 2008 (estimated)	FY 2008 Percentage of distributed total
		Previous authority	New authority	Total		
Alabama	111,839					
Alaska	16,846					
Arizona	7,164					
Arkansas	45,375					
California	173,937					
Colorado	12,123					
Connecticut	14,707					
Delaware	6,942					
District of Columbia	1,772					
Florida	1,822,569					
Georgia	17,262					
Hawaii	25,386					
Idaho	2,370					
Illinois	13,546					
Indiana	4,691					
Iowa	1,284					
Kansas	48,095					
Kentucky	4,878					
Louisiana	2,988,611					
Maine	5,416					
Maryland	10,194					
Massachusetts	25,969					
Michigan	1,481					
Minnesota	17,595					
Mississippi	1,548,706					
Missouri	16,793					
Montana	397					
Nebraska	6,619					
Nevada	9,990					
New Hampshire	24,278					
New Jersey	2,794					
New Mexico	1,628					
New York	59,622					
North Carolina	27,300					
North Dakota	16,854					
Ohio	5,305					
Oklahoma	16,859					
Oregon	8,414					
Pennsylvania	42,947					
Rhode Island	1,110					
South Carolina	14,643					
South Dakota	25,019					
Tennessee	44,599					
Texas	851,540					
Utah	3,234					
Vermont	61					
Virginia	11,525					
Washington	6,854					
West Virginia	1,240					
Wisconsin	1,149					
Wyoming						
American Samoa	1,659					
Guam	276					
Northern Mariana Islands	1,333					
Puerto Rico	14,539					
Freely Associated States						
Virgin Islands	- 862					
Indian Tribes						
Undistributed						
Micronesia	852					
<b>Total</b>	<b>8,147,330</b>			1	1	

<sup>1</sup> Grants are funded as needed through the Disaster Relief Fund, and are not awarded unless a state has significant damage from a declared major disaster. There are no estimates for 2007 and 2008 since disaster-related damages have not yet occurred.

**Table 8-30. Public Housing Operating Fund (14.850)**

(Obligations in thousands of dollars)

State or Territory	FY 2006 Actual	Estimated FY 2007 obligations from:			FY 2008 (estimated)	FY 2008 Percentage of distributed total
		Previous authority	New authority	Total		
Alabama	105,777	36	105,780	105,816	118,720	2.97
Alaska	7,953	3	7,954	7,957	8,927	0.22
Arizona	15,290	5	15,291	15,296	17,162	0.43
Arkansas	25,785	9	25,786	25,795	28,940	0.72
California	102,907	35	102,910	102,945	115,499	2.89
Colorado	20,605	7	20,606	20,613	23,127	0.58
Connecticut	56,203	19	56,205	56,224	63,081	1.58
Delaware	8,988	3	8,988	8,991	10,088	0.25
District of Columbia	40,862	14	40,863	40,877	45,862	1.15
Florida	86,675	30	86,678	86,708	97,281	2.43
Georgia	108,382	37	108,385	108,422	121,645	3.04
Hawaii	10,417	4	10,416	10,420	11,692	0.29
Idaho	991		991	991	1,112	0.03
Illinois	232,696	80	232,702	232,782	261,170	6.53
Indiana	39,265	13	39,266	39,279	44,069	1.10
Iowa	5,517	2	5,518	5,520	6,192	0.15
Kansas	15,957	5	15,957	15,962	17,910	0.45
Kentucky	52,913	18	52,915	52,933	59,388	1.48
Louisiana	60,189	21	60,191	60,212	67,554	1.69
Maine	9,949	3	9,950	9,953	11,167	0.28
Maryland	74,032	25	74,033	74,058	83,091	2.08
Massachusetts	120,793	42	120,795	120,837	135,574	3.39
Michigan	49,838	17	49,840	49,857	55,937	1.40
Minnesota	44,941	15	44,942	44,957	50,440	1.26
Mississippi	28,014	10	28,015	28,025	31,442	0.79
Missouri	37,157	13	37,159	37,172	41,704	1.04
Montana	4,116	1	4,115	4,116	4,620	0.12
Nebraska	11,426	4	11,427	11,431	12,825	0.32
Nevada	14,499	5	14,500	14,505	16,274	0.41
New Hampshire	7,785	3	7,785	7,788	8,738	0.22
New Jersey	168,489	58	168,493	168,551	189,107	4.73
New Mexico	8,187	3	8,188	8,191	9,189	0.23
New York	904,356	310	904,382	904,692	1,015,019	25.38
North Carolina	96,267	33	96,270	96,303	108,047	2.70
North Dakota	2,246	1	2,246	2,247	2,521	0.06
Ohio	173,629	60	173,634	173,694	194,875	4.87
Oklahoma	25,324	9	25,325	25,334	28,423	0.71
Oregon	15,255	5	15,255	15,260	17,121	0.43
Pennsylvania	244,823	84	244,830	244,914	274,780	6.87
Rhode Island	21,864	8	21,865	21,873	24,539	0.61
South Carolina	29,223	10	29,224	29,234	32,799	0.82
South Dakota	2,398	1	2,398	2,399	2,691	0.07
Tennessee	87,377	30	87,380	87,410	98,069	2.45
Texas	119,403	41	119,406	119,447	134,013	3.35
Utah	4,150	1	4,150	4,151	4,658	0.12
Vermont	2,545	1	2,545	2,546	2,857	0.07
Virginia	63,692	22	63,694	63,716	71,485	1.79
Washington	34,042	12	34,043	34,055	38,207	0.96
West Virginia	16,766	6	16,766	16,772	18,817	0.47
Wisconsin	20,565	7	20,566	20,573	23,081	0.58
Wyoming	1,272	1	1,271	1,272	1,428	0.04
American Samoa						
Guam	3,039	1	3,039	3,040	3,411	0.09
Northern Mariana Islands						
Puerto Rico	100,525	34	100,528	100,562	112,826	2.82
Freely Associated States						
Virgin Islands	18,539	6	18,539	18,545	20,806	0.52
Indian Tribes						
Undistributed						
<b>Total</b>	<b>3,563,898</b>	<b>1,223</b>	<b>3,564,000</b>	<b>3,565,223</b>	<b>4,000,000</b>	<b>1 100.00</b>

<sup>1</sup> Excludes undistributed obligations.

**Table 8-31. Section 8 Housing Choice Vouchers (14.871)**

(Obligations in thousands of dollars)

State or Territory	FY 2006 Actual	Estimated FY 2007 obligations from:			FY 2008 (estimated)	FY 2008 Percentage of distributed total
		Previous authority	New authority	Total		
Alabama	127,597	4,350	140,824	145,174	149,406	0.93
Alaska	25,208	859	27,821	28,681	29,517	0.18
Arizona	123,774	4,220	136,604	140,824	144,929	0.91
Arkansas	80,666	2,750	89,028	91,778	94,453	0.59
California	2,494,118	85,038	2,752,653	2,837,691	2,920,407	18.25
Colorado	188,818	6,438	208,391	214,829	221,091	1.38
Connecticut	268,159	9,143	295,956	305,099	313,992	1.96
Delaware	29,239	997	32,270	33,267	34,237	0.21
District of Columbia	111,868	3,814	123,465	127,279	130,989	0.82
Florida	600,515	20,475	662,763	683,238	703,154	4.39
Georgia	351,497	11,984	387,933	399,917	411,574	2.57
Hawaii	76,922	2,623	84,896	87,518	90,069	0.56
Idaho	30,449	1,038	33,605	34,643	35,653	0.22
Illinois	682,461	23,269	753,204	776,472	799,106	4.99
Indiana	167,166	5,700	184,494	190,193	195,737	1.22
Iowa	78,936	2,691	87,119	89,810	92,428	0.58
Kansas	47,632	1,624	52,569	54,193	55,773	0.35
Kentucky	136,301	4,647	150,429	155,077	159,597	1.00
Louisiana	204,130	6,960	225,290	232,250	239,019	1.49
Maine	63,454	2,163	70,032	72,195	74,300	0.46
Maryland	305,871	10,429	337,578	348,006	358,150	2.24
Massachusetts	679,638	23,173	750,088	773,261	795,801	4.97
Michigan	265,481	9,052	293,000	302,052	310,856	1.94
Minnesota	183,294	6,249	202,294	208,544	214,623	1.34
Mississippi	94,177	3,211	103,940	107,151	110,274	0.69
Missouri	186,318	6,353	205,631	211,984	218,163	1.36
Montana	24,364	831	26,889	27,720	28,528	0.18
Nebraska	51,180	1,745	56,485	58,230	59,928	0.37
Nevada	87,228	2,974	96,270	99,244	102,137	0.64
New Hampshire	62,097	2,117	68,534	70,651	72,711	0.45
New Jersey	526,783	17,961	581,388	599,349	616,819	3.86
New Mexico	63,563	2,167	70,152	72,319	74,427	0.47
New York	1,595,757	54,408	1,761,170	1,815,578	1,868,501	11.68
North Carolina	275,520	9,394	304,080	313,474	322,612	2.02
North Dakota	25,766	878	28,437	29,315	30,170	0.19
Ohio	447,835	15,269	494,257	509,526	524,378	3.28
Oklahoma	107,139	3,653	118,245	121,898	125,451	0.78
Oregon	164,645	5,614	181,712	187,326	192,786	1.20
Pennsylvania	432,950	14,762	477,829	492,591	506,949	3.17
Rhode Island	141,099	4,811	155,725	160,536	165,215	1.03
South Carolina	55,916	1,906	61,712	63,618	65,473	0.41
South Dakota	107,206	3,655	118,319	121,974	125,530	0.78
Tennessee	22,616	771	24,960	25,731	26,481	0.17
Texas	151,665	5,171	167,387	172,558	177,588	1.11
Utah	860,784	29,349	950,011	979,360	1,007,907	6.30
Vermont	55,851	1,904	61,640	63,544	65,397	0.41
Virginia	34,542	1,178	38,122	39,300	40,446	0.25
Washington	267,173	9,109	294,868	303,977	312,838	1.96
West Virginia	284,715	9,707	314,228	323,935	333,377	2.08
Wisconsin	51,357	1,751	56,681	58,432	60,135	0.38
Wyoming	120,411	4,105	132,893	136,998	140,992	0.88
American Samoa	8,822	301	9,737	10,038	10,330	0.06
Guam	24,443	833	26,977	27,811	28,621	0.18
Northern Mariana Islands	2,011	69	2,219	2,288	2,355	0.01
Puerto Rico	.....	.....	.....	.....	.....	.....
Freely Associated States	.....	.....	.....	.....	.....	.....
Virgin Islands	7,364	251	8,127	8,378	8,623	0.05
Indian Tribes	.....	.....	.....	.....	.....	.....
Undistributed	.....	.....	.....	.....	.....	.....
Disaster Assistance	132,297	258,003	.....	258,003	.....	.....
<b>Total</b>	<b>13,796,790</b>	<b>723,899</b>	<b>15,080,930</b>	<b>15,804,830</b>	<b>16,000,000</b>	<b>1 100.00</b>

<sup>1</sup> Excludes undistributed obligations.

**Table 8-32. Public Housing Capital Fund (14.872)**

(Obligations in thousands of dollars)

State or Territory	FY 2006 Actual	Estimated FY 2007 obligations from:			FY 2008 (estimated)	FY 2008 Percentage of distributed total
		Previous authority	New authority	Total		
Alabama	74,004	10,282	67,826	78,108	62,174	3.07
Alaska	2,684	373	2,460	2,833	2,255	0.11
Arizona	11,120	1,545	10,191	11,736	9,342	0.46
Arkansas	22,002	3,057	20,164	23,221	18,484	0.91
California	100,539	13,969	92,145	106,114	84,466	4.17
Colorado	15,451	2,147	14,160	16,307	12,980	0.64
Connecticut	33,286	4,625	30,506	35,131	27,964	1.38
Delaware	5,172	719	4,740	5,459	4,345	0.21
District of Columbia	32,991	4,584	30,237	34,821	27,717	1.37
Florida	81,434	11,315	74,635	85,950	68,415	3.38
Georgia	90,927	12,634	83,335	95,969	76,390	3.77
Hawaii	13,756	1,911	12,608	14,519	11,557	0.57
Idaho	1,163	162	1,066	1,228	977	0.05
Illinois	174,966	24,310	160,357	184,667	146,994	7.26
Indiana	31,987	4,444	29,316	33,760	26,873	1.33
Iowa	5,958	828	5,461	6,289	5,006	0.25
Kansas	13,193	1,833	12,092	13,925	11,084	0.55
Kentucky	44,145	6,134	40,459	46,593	37,087	1.83
Louisiana	85,130	11,828	78,022	89,850	71,520	3.53
Maine	6,477	900	5,937	6,837	5,442	0.27
Maryland	46,050	6,398	42,204	48,602	38,687	1.91
Massachusetts	66,694	9,267	61,125	70,392	56,031	2.77
Michigan	46,547	6,467	42,661	49,128	39,106	1.93
Minnesota	35,343	4,911	32,392	37,303	29,693	1.47
Mississippi	32,255	4,482	29,563	34,045	27,099	1.34
Missouri	39,839	5,535	36,513	42,048	33,470	1.65
Montana	3,418	475	3,132	3,607	2,871	0.14
Nebraska	9,927	1,379	9,098	10,477	8,340	0.41
Nevada	10,809	1,502	9,908	11,410	9,082	0.45
New Hampshire	5,906	821	5,412	6,233	4,961	0.25
New Jersey	83,574	11,612	76,596	88,208	70,213	3.47
New Mexico	8,379	1,164	7,680	8,844	7,040	0.35
New York	407,605	56,634	373,571	430,205	342,440	16.92
North Carolina	63,768	8,859	58,443	67,302	53,573	2.65
North Dakota	-89,446	-12,428	-81,977	-94,405	-75,146	-3.71
Ohio	103,676	14,405	95,019	109,424	87,101	4.30
Oklahoma	21,551	2,994	19,751	22,745	18,105	0.89
Oregon	11,436	1,589	10,480	12,069	9,607	0.47
Pennsylvania	167,687	23,299	153,685	176,984	140,878	6.96
Rhode Island	15,409	2,141	14,123	16,264	12,946	0.64
South Carolina	26,877	3,734	24,634	28,368	22,581	1.12
South Dakota	2,053	285	1,882	2,167	1,725	0.09
Tennessee	65,426	9,091	59,963	69,054	54,966	2.72
Texas	98,404	13,672	90,188	103,860	82,672	4.08
Utah	3,562	495	3,264	3,759	2,992	0.15
Vermont	2,902	403	2,660	3,063	2,438	0.12
Virginia	55,883	7,765	51,217	58,982	46,949	2.32
Washington	32,047	4,453	29,371	33,824	26,923	1.33
West Virginia	10,650	1,480	9,760	11,240	8,947	0.44
Wisconsin	21,463	2,981	19,670	22,651	18,031	0.89
Wyoming	1,080	150	989	1,139	907	0.04
American Samoa						
Guam	2,783	387	2,551	2,938	2,338	0.12
Northern Mariana Islands						
Puerto Rico	140,910	19,578	129,144	148,722	118,382	5.85
Freely Associated States						
Virgin Islands	8,308	1,154	7,615	8,769	6,980	0.34
Indian Tribes						
Undistributed						
<b>Total</b>	<b>2,409,160</b>	<b>334,734</b>	<b>2,208,000</b>	<b>2,542,734</b>	<b>2,024,000</b>	<b>1 100.00</b>

<sup>1</sup> Excludes undistributed obligations.

**Table 8-33. Community Development Block Grants (14.218)**

(Obligations in thousands of dollars)

State or Territory	FY 2006 Actual	Estimated FY 2007 obligations from:			FY 2008 (estimated)	FY 2008 Percentage of distributed total
		Previous authority	New authority	Total		
Alabama	50,788	2,968	51,956	54,924	37,198	1.54
Alaska	4,749		4,966	4,966	3,555	0.15
Arizona	55,309		56,969	56,969	40,787	1.69
Arkansas	27,654		28,958	28,958	20,733	0.86
California	480,027	71,904	492,314	564,218	352,475	14.57
Colorado	40,129	299	40,312	40,611	28,862	1.19
Connecticut	39,212	21,963	43,946	65,909	31,463	1.30
Delaware	7,265		7,588	7,588	5,433	0.22
District of Columbia	21,318	19,275	19,570	38,845	14,011	0.58
Florida	173,253	111,108	169,636	280,744	121,452	5.02
Georgia	83,164		86,888	86,888	62,208	2.57
Hawaii	15,362		16,034	16,034	11,480	0.47
Idaho	11,176	1,324	12,807	14,131	9,169	0.38
Illinois	184,134	25,499	184,729	210,228	132,258	5.47
Indiana	80,895	2,372	73,973	76,345	52,961	2.19
Iowa	41,419		43,378	43,378	31,057	1.28
Kansas	25,586	2,485	29,402	31,887	21,050	0.87
Kentucky	46,705		48,021	48,021	34,381	1.42
Louisiana	58,207	11,307	65,464	76,771	46,869	1.94
Maine	20,040		20,828	20,828	14,912	0.62
Maryland	57,100	8,511	58,583	67,094	41,943	1.73
Massachusetts	120,971	481	115,618	116,099	82,777	3.42
Michigan	138,796		138,827	138,827	99,394	4.11
Minnesota	61,912	491	61,168	61,659	43,794	1.81
Mississippi	35,644	3,094	37,051	40,145	26,527	1.10
Missouri	67,950	769	71,029	71,798	50,854	2.10
Montana	9,236		9,688	9,688	6,936	0.29
Nebraska	21,305		20,440	20,440	14,634	0.61
Nevada	20,332		21,316	21,316	15,261	0.63
New Hampshire	13,278		13,919	13,919	9,965	0.41
New Jersey	108,937	28,144	106,359	134,503	76,148	3.15
New Mexico	21,193	445	22,157	22,602	15,863	0.66
New York	374,643	22,905	368,230	391,135	263,636	10.90
North Carolina	73,787		74,998	74,998	53,695	2.22
North Dakota	6,390		6,693	6,693	4,792	0.20
Ohio	164,287	7,583	170,739	178,322	122,241	5.05
Oklahoma	31,032	4,616	31,883	36,499	22,827	0.94
Oregon	38,405		38,602	38,602	27,637	1.14
Pennsylvania	222,491	8,780	233,915	242,695	167,473	6.92
Rhode Island	18,138		18,067	18,067	12,935	0.53
South Carolina	35,795	5,031	40,929	45,960	29,303	1.21
South Dakota	8,024		8,416	8,416	6,025	0.25
Tennessee	50,425		52,727	52,727	37,750	1.56
Texas	265,035	95,902	268,828	364,730	192,469	7.96
Utah	20,446	3,171	21,689	24,860	15,528	0.64
Vermont	8,369		8,789	8,789	6,293	0.26
Virginia	64,727	4,731	64,541	69,272	46,208	1.91
Washington	61,696	3,441	64,748	68,189	46,357	1.92
West Virginia	25,166	112	26,452	26,564	18,938	0.78
Wisconsin	65,898	2,726	70,376	73,102	50,386	2.08
Wyoming	4,233	460	4,430	4,890	3,172	0.13
American Samoa	1,020	1,018	1,028	2,046	1,028	0.04
Guam	2,757	2,751	2,779	5,530	2,779	0.11
Northern Mariana Islands	1,233	1,230	1,243	2,473	1,243	0.05
Puerto Rico	112,482	1,371	116,634	118,005	83,505	3.45
Freely Associated States						
Virgin Islands	1,934	1,930	1,950	3,880	1,950	0.08
Indian Tribes						
Undistributed	21,541				200,000	
Brownfields			15,000	15,000		
Economic Development Initiative Rescission					- 356,000	- 14.72
Adjustments to Prior Year Funds		- 12,777		- 12,777		
<b>Total<sup>1</sup></b>	<b><sup>2</sup> 3,823,000</b>	<b>467,420</b>	<b>3,887,580</b>	<b><sup>3</sup> 4,355,000</b>	<b><sup>3</sup> 2,618,580</b>	<b><sup>4</sup> 100.00</b>

<sup>1</sup> Includes Small Cities Program (CFDA 14.219), Special Purpose Grants/Insular Areas (CFDA 14.225), State's Program (CFDA 14.228), and Brownfields Economic Development Initiative (CFDA 14.246).

<sup>2</sup> Excludes Disaster Supplementals.

<sup>3</sup> Based on estimated budget authority.

<sup>4</sup> Excludes undistributed obligations.

**Table 8-34. Mineral Leasing and Associated Payments (1)**

(Obligations in thousands of dollars)

State or Territory	FY 2006 Actual	Estimated FY 2007 obligations from:			FY 2008 (estimated)	FY 2008 Percentage of distributed total
		Previous authority	New authority	Total		
Alabama	457		406	406	432	0.02
Alaska	14,431		12,811	12,811	13,626	0.68
Arizona	135		120	120	127	0.01
Arkansas	3,030		2,690	2,690	2,861	0.14
California	47,481		42,151	42,151	44,833	2.25
Colorado	147,408		130,861	130,861	139,187	6.98
Connecticut						
Delaware						
District of Columbia						
Florida	142		126	126	134	0.01
Georgia						
Hawaii						
Idaho	1,275		1,132	1,132	1,204	0.06
Illinois						
Indiana						
Iowa						
Kansas	2,447		2,172	2,172	2,311	0.12
Kentucky						
Louisiana	790		701	701	746	0.04
Maine						
Maryland						
Massachusetts						
Michigan	552		490	490	521	0.03
Minnesota	1		1	1	1	*
Mississippi	73		65	65	69	*
Missouri						
Montana	38,273		33,977	33,977	36,138	1.81
Nebraska	28		24	24	26	*
Nevada	7,697		6,833	6,833	7,268	0.36
New Hampshire						
New Jersey						
New Mexico	574,195		509,741	509,741	542,171	27.18
New York						
North Carolina						
North Dakota	15,244		13,533	13,533	14,394	0.72
Ohio						
Oklahoma	4,598		4,082	4,082	4,342	0.22
Oregon	657		583	583	620	0.03
Pennsylvania						
Rhode Island						
South Carolina						
South Dakota	850		755	755	803	0.04
Tennessee						
Texas	5,355		4,754	4,754	5,056	0.25
Utah	173,132		153,698	153,698	163,476	8.20
Vermont						
Virginia						
Washington	1,082		961	961	1,022	0.05
West Virginia						
Wisconsin						
Wyoming	1,073,217		952,746	952,746	1,013,361	50.80
American Samoa						
Guam						
Northern Mariana Islands						
Puerto Rico						
Freely Associated States						
Virgin Islands						
Indian Tribes						
Undistributed						
<b>Total <sup>1</sup></b>	<b>2,112,550</b>		<b>1,875,413</b>	<b>1,875,413</b>	<b>1,994,729</b>	<sup>2</sup> <b>100.00</b>

\* \$500 or less or 0.005 percent or less.

<sup>1</sup> This program is not included in the Catalog of Federal Domestic Assistance.

<sup>2</sup> Excludes undistributed obligations.



**Table 8-35. Airport Improvement Program (20.106)**

(Obligations in thousands of dollars)

State or Territory	FY 2006 Actual	Estimated FY 2007 obligations from:			FY 2008 (estimated)	FY 2008 Percentage of distributed total
		Previous authority	New authority	Total		
Alabama	59,317		56,132	56,132	43,285	1.64
Alaska	232,319		219,842	219,842	169,528	6.42
Arizona	71,738		67,885	67,885	52,349	1.98
Arkansas	35,625		33,712	33,712	25,997	0.98
California	317,795		300,728	300,728	231,902	8.78
Colorado	90,562		85,699	85,699	66,085	2.50
Connecticut	11,106		10,510	10,510	8,104	0.31
Delaware	6,322		5,983	5,983	4,613	0.17
District of Columbia	355		336	336	259	0.01
Florida	1 172,084		162,600	162,600	125,387	4.75
Georgia	96,322		91,149	91,149	70,288	2.66
Hawaii	33,076		31,300	31,300	24,136	0.91
Idaho	22,102		20,915	20,915	16,128	0.61
Illinois	159,073		150,530	150,530	116,079	4.40
Indiana	59,631		56,429	56,429	43,514	1.65
Iowa	40,959		38,759	38,759	29,889	1.13
Kansas	22,714		21,494	21,494	16,575	0.63
Kentucky	86,935		82,266	82,266	63,439	2.40
Louisiana	73,411		69,469	69,469	53,570	2.03
Maine	18,975		17,956	17,956	13,846	0.52
Maryland	37,672		35,649	35,649	27,490	1.04
Massachusetts	38,354		36,294	36,294	27,988	1.06
Michigan	110,228		104,308	104,308	80,436	3.05
Minnesota	65,442		61,927	61,927	47,754	1.81
Mississippi	110,723		104,776	104,776	80,797	3.06
Missouri	80,579		76,251	76,251	58,800	2.23
Montana	32,695		30,939	30,939	23,858	0.90
Nebraska	28,178		26,665	26,665	20,562	0.78
Nevada	44,720		42,319	42,319	32,633	1.24
New Hampshire	36,333		34,382	34,382	26,513	1.00
New Jersey	57,919		54,808	54,808	42,265	1.60
New Mexico	24,819		23,486	23,486	18,111	0.69
New York	155,910		147,537	147,537	113,771	4.31
North Carolina	65,624		62,099	62,099	47,887	1.81
North Dakota	19,499		18,452	18,452	14,229	0.54
Ohio	87,114		82,436	82,436	63,569	2.41
Oklahoma	45,615		43,166	43,166	33,287	1.26
Oregon	34,879		33,006	33,006	25,452	0.96
Pennsylvania	120,634		114,156	114,156	88,030	3.33
Rhode Island	25,758		24,375	24,375	18,796	0.71
South Carolina	27,419		25,947	25,947	20,009	0.76
South Dakota	24,073		22,780	22,780	17,567	0.67
Tennessee	68,291		64,624	64,624	49,834	1.89
Texas	266,211		251,914	251,914	194,260	7.36
Utah	46,630		44,126	44,126	34,027	1.29
Vermont	7,350		6,955	6,955	5,363	0.20
Virginia	84,730		80,179	80,179	61,829	2.34
Washington	95,985		90,830	90,830	70,042	2.65
West Virginia	31,463		29,773	29,773	22,959	0.87
Wisconsin	61,663		58,351	58,351	44,997	1.70
Wyoming	17,701		16,750	16,750	12,917	0.49
American Samoa						
Guam	9,532		9,020	9,020	6,956	0.26
Northern Mariana Islands	29,999		28,388	28,388	21,891	0.83
Puerto Rico	11,440		10,832	10,832	8,353	0.32
Freely Associated States						
Virgin Islands	3,299		3,121	3,121	2,407	0.09
Indian Tribes						
Undistributed	90,339		90,185	90,185	109,388	
<b>Total</b>	<b>3,709,241</b>		<b>3,514,500</b>	<b>3,514,500</b>	<b>2,750,000</b>	<sup>2</sup> <b>100.00</b>

<sup>1</sup> Includes Emergency Response Grant funding.

<sup>2</sup> Excludes undistributed obligations.

**Table 8-36. Highway Planning and Construction (20.205)**

(Obligations in thousands of dollars)

State or Territory	FY 2006 Actual	Estimated FY 2007 obligations from:			FY 2008 (estimated)	FY 2008 Percentage of distributed total
		Previous authority	New authority	Total		
Alabama	618,975		548,700	548,700	654,118	1.99
Alaska	372,147		250,267	250,267	297,346	0.91
Arizona	476,573		538,529	538,529	607,839	1.85
Arkansas	433,870		347,184	347,184	415,195	1.26
California	2,850,603		2,408,038	2,408,038	3,156,772	9.61
Colorado	383,086		360,141	360,141	445,235	1.36
Connecticut	431,712		366,382	366,382	429,975	1.31
Delaware	140,484		109,353	109,353	131,851	0.40
District of Columbia	128,947		111,043	111,043	132,757	0.40
Florida	2,047,791		1,406,291	1,406,291	1,569,233	4.78
Georgia	1,095,630		969,692	969,692	1,156,480	3.52
Hawaii	110,882		115,267	115,267	136,719	0.42
Idaho	228,981		203,333	203,333	242,347	0.74
Illinois	1,023,014		910,388	910,388	1,140,222	3.47
Indiana	753,457		704,288	704,288	832,033	2.53
Iowa	339,701		295,144	295,144	361,208	1.10
Kansas	390,821		278,297	278,297	332,208	1.01
Kentucky	499,581		472,047	472,047	564,936	1.72
Louisiana	1,241,933		428,616	428,616	513,048	1.56
Maine	170,867		122,527	122,527	150,249	0.46
Maryland	475,565		441,365	441,365	514,730	1.57
Massachusetts	572,088		451,909	451,909	541,395	1.65
Michigan	976,091		821,004	821,004	1,050,691	3.20
Minnesota	474,610		437,258	437,258	567,992	1.73
Mississippi	1,262,560		329,837	329,837	391,126	1.19
Missouri	676,453		645,400	645,400	773,247	2.35
Montana	329,907		262,635	262,635	312,985	0.95
Nebraska	266,371		201,577	201,577	243,429	0.74
Nevada	274,778		189,509	189,509	212,782	0.65
New Hampshire	150,699		124,655	124,655	147,376	0.45
New Jersey	724,937		742,676	742,676	848,554	2.58
New Mexico	304,090		263,313	263,313	314,681	0.96
New York	1,388,547		1,235,368	1,235,368	1,463,313	4.45
North Carolina	847,860		790,658	790,658	938,729	2.86
North Dakota	242,982		170,821	170,821	205,828	0.63
Ohio	1,087,836		1,003,336	1,003,336	1,215,672	3.70
Oklahoma	500,605		417,431	417,431	503,858	1.53
Oregon	354,465		312,843	312,843	376,965	1.15
Pennsylvania	1,191,352		1,231,575	1,231,575	1,453,084	4.42
Rhode Island	184,152		138,243	138,243	162,932	0.50
South Carolina	528,297		463,552	463,552	524,163	1.60
South Dakota	227,132		183,777	183,777	220,571	0.67
Tennessee	615,152		608,526	608,526	707,799	2.15
Texas	2,584,506		2,336,793	2,336,793	2,668,568	8.12
Utah	231,410		198,305	198,305	235,490	0.72
Vermont	161,911		116,196	116,196	143,266	0.44
Virginia	667,161		752,517	752,517	867,826	2.64
Washington	693,629		464,963	464,963	566,351	1.72
West Virginia	427,069		297,110	297,110	355,794	1.08
Wisconsin	608,062		535,233	535,233	637,629	1.94
Wyoming	205,296		187,340	187,340	225,021	0.69
American Samoa	8,149		5,529	5,529	6,452	0.02
Guam	13,611		9,236	9,236	10,777	0.03
Northern Mariana Islands	4,862		3,299	3,299	3,850	0.01
Puerto Rico	93,690		110,025	110,025	137,895	0.42
Freely Associated States						
Virgin Islands	33,433		22,686	22,686	26,471	0.08
Indian Tribes						
Undistributed			8,219,992	8,219,992	6,738,016	
<b>Total</b>	<b>33,128,373</b>		<b>35,672,019</b>	<b>35,672,019</b>	<b>39,585,079</b>	<b>1 100.00</b>

<sup>1</sup> Excludes undistributed obligations.

**Table 8-37. Capital Investment Grants—Fixed Guideway Modernization (Section 5309) (20.500)**

(Obligations in thousands of dollars)

State or Territory	FY 2006 Actual	Estimated FY 2007 obligations from:			FY 2008 (estimated)	FY 2008 Percentage of distributed total
		Previous authority	New authority	Total		
Alabama						
Alaska	12,758	146	10,138	10,284	21,263	1.25
Arizona	2,288	1,327	2,062	3,389	3,734	0.22
Arkansas						
California	135,963	24,133	130,612	154,745	232,484	13.67
Colorado	4,503		2,677	2,677	5,340	0.31
Connecticut	43,825	22,730	32,925	55,655	50,358	2.96
Delaware						
District of Columbia	70,359	3,012	45,518	48,530	84,789	4.98
Florida	21,251	7,036	16,645	23,681	30,827	1.81
Georgia	8,857	18,990	21,835	40,825	42,780	2.52
Hawaii	2,400	157	970	1,126	1,817	0.11
Idaho						
Illinois	168,374	1,371	110,702	112,074	174,055	10.23
Indiana	13,891		7,192	7,192	11,591	0.68
Iowa						
Kansas						
Kentucky						
Louisiana	2,667	804	2,492	3,296	3,813	0.22
Maine						
Maryland	50,803	15,174	23,579	38,754	39,804	2.34
Massachusetts	103,609	29,265	63,138	92,403	100,627	5.92
Michigan	1,224		252	252	485	0.03
Minnesota	2,400	8,276	5,420	13,695	9,739	0.57
Mississippi						
Missouri	8,355	16	3,415	3,431	6,730	0.40
Montana						
Nebraska						
Nevada						
New Hampshire						
New Jersey	93,563	3,150	86,183	89,333	133,509	7.85
New Mexico						
New York	519,390	791	305,013	305,804	481,989	28.34
North Carolina						
North Dakota						
Ohio	22,659	1,699	14,407	16,106	22,927	1.35
Oklahoma						
Oregon	7,525	*	5,847	5,847	6,831	0.40
Pennsylvania	28,834	45,089	81,264	126,353	124,611	7.33
Rhode Island	525	1,378	59	1,437	107	0.01
South Carolina						
South Dakota						
Tennessee	89	210	342	552	524	0.03
Texas	29,616	7,462	11,596	19,058	21,239	1.25
Utah						
Vermont						
Virginia	9,645		14,830	14,830	27,630	1.62
Washington	26,275	1,409	20,414	21,822	35,895	2.11
West Virginia		1,025	855	1,880	1,599	0.09
Wisconsin	785	260	820	1,080	1,615	0.09
Wyoming						
American Samoa						
Guam						
Northern Mariana Islands						
Puerto Rico	877	2,070	1,641	3,711	3,358	0.20
Freely Associated States						
Virgin Islands						
Indian Tribes						
Undistributed						
Oversight	13,298		13,298	13,298	18,854	1.11
<b>Total<sup>1</sup></b>	<b>1,406,611</b>	<b>196,980</b>	<b>1,036,142</b>	<b>1,233,122</b>	<b>1,700,923</b>	<sup>2</sup> <b>100.00</b>

\* \$500 or less or 0.005 percent or less.

<sup>1</sup> Includes funding from the Formula and Bus Grants Program (69X8350).

<sup>2</sup> Excludes undistributed obligations.

**Table 8-38. Federal Transit Formula Grants and Research (20.507)**

(Obligations in thousands of dollars)

State or Territory	FY 2006 Actual	Estimated FY 2007 obligations from:			FY 2008 (estimated)	FY 2008 Percentage of distributed total
		Previous authority	New authority	Total		
Alabama	44,912	12,539	27,461	40,001	47,660	0.73
Alaska	23,818	5,020	21,857	26,877	38,650	0.59
Arizona	86,475	33,732	52,365	86,097	93,884	1.43
Arkansas	20,437	2,648	16,558	19,206	28,230	0.43
California	828,993	212,526	535,338	747,864	978,117	14.89
Colorado	72,793	4,132	50,443	54,575	87,656	1.33
Connecticut	71,059	44,329	54,261	98,590	98,542	1.50
Delaware	15,574	1,367	9,483	10,850	16,701	0.25
District of Columbia	133,260	11,648	55,579	67,228	102,258	1.56
Florida	197,020	76,751	171,374	248,125	308,158	4.69
Georgia	124,679	48,743	75,660	124,402	135,123	2.06
Hawaii	22,381	3,209	21,672	24,881	42,018	0.64
Idaho	10,593	2,901	10,281	13,182	17,661	0.27
Illinois	322,588	12,161	197,699	209,860	360,150	5.48
Indiana	57,379	22,743	44,683	67,427	80,469	1.23
Iowa	28,286	4,452	20,841	25,293	36,310	0.55
Kansas	12,975	10,844	17,193	28,036	29,439	0.45
Kentucky	29,299	5,387	27,660	33,048	48,438	0.74
Louisiana	35,556	19,706	36,256	55,962	65,311	0.99
Maine	19,599	1,805	8,150	9,955	13,695	0.21
Maryland	83,713	14,882	84,699	99,581	154,311	2.35
Massachusetts	117,962	72,869	134,291	207,161	251,367	3.83
Michigan	112,398	11,695	76,725	88,420	138,384	2.11
Minnesota	105,947	26,391	48,343	74,734	86,246	1.31
Mississippi	15,731	7,099	15,184	22,284	25,725	0.39
Missouri	80,944	14,739	45,616	60,355	80,769	1.23
Montana	7,010	4,146	8,590	12,736	14,272	0.22
Nebraska	16,073	2,063	12,858	14,921	21,867	0.33
Nevada	57,279	12,936	25,108	38,044	42,062	0.64
New Hampshire	22,022	3,599	7,840	11,439	13,479	0.21
New Jersey	214,384	14,442	221,942	236,384	404,893	6.16
New Mexico	18,869	10,234	15,093	25,327	26,496	0.40
New York	759,866	488,464	503,768	992,232	924,181	14.07
North Carolina	69,056	35,594	55,473	91,067	98,093	1.49
North Dakota	8,912	237	6,296	6,533	10,627	0.16
Ohio	205,835	25,658	95,353	121,011	172,746	2.63
Oklahoma	33,855	2,387	22,137	24,525	38,997	0.59
Oregon	99,939	3,077	40,102	43,178	71,395	1.09
Pennsylvania	504,096	63,651	147,579	211,230	269,748	4.11
Rhode Island	18,856	8,956	15,146	24,102	27,227	0.41
South Carolina	38,048	9,621	23,938	33,559	42,807	0.65
South Dakota	9,570	1,049	6,468	7,517	10,737	0.16
Tennessee	61,228	11,683	39,394	51,078	68,858	1.05
Texas	281,590	67,939	207,119	275,059	379,558	5.78
Utah	43,440	1,209	28,753	29,963	52,435	0.80
Vermont	11,344	253	3,751	4,004	6,455	0.10
Virginia	101,462	32,771	60,082	92,853	107,821	1.64
Washington	84,624	38,867	92,268	131,135	164,920	2.51
West Virginia	13,614	1,434	11,275	12,709	19,351	0.29
Wisconsin	66,401	11,835	46,497	58,331	83,621	1.27
Wyoming	4,381	1,725	5,187	6,912	8,414	0.13
American Samoa		297	395	692	490	0.01
Guam	982		669	669	1,071	0.02
Northern Mariana Islands	949		739	739	1,373	0.02
Puerto Rico	76,769	27,113	49,111	76,224	75,081	1.14
Freely Associated States						
Virgin Islands	157	460	837	1,297	1,517	0.02
Indian Tribes						
Undistributed						
Oversight	28,685		31,542	31,542	41,966	0.64
<b>Total 1</b>	<b>5,533,669</b>	<b>1,566,024</b>	<b>3,644,980</b>	<b>5,211,004</b>	<b>6,567,831</b>	<b>2 100.00</b>

<sup>1</sup> Includes Metropolitan Planning (CFDA 20.505), Formula Program for Non-Urbanized Areas (CFDA 20.509), Rural Transportation Assistance Program (CFDA 20.509), Elderly and Persons with Disabilities (CFDA 20.513), Job Access and Reverse Commute (CFDA 20.516), and New Freedom Initiative (CFDA 20.521).

<sup>2</sup> Excludes undistributed obligations.

## 9. INTEGRATING SERVICES WITH INFORMATION TECHNOLOGY

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 its capabilities in managing technology and information in order to be the world's leader in information technology. This year, the President proposes to spend about \$65 billion for Information Tech-

nology (IT) and the associated support services. Departments and agencies continue to build upon their successes including their efforts with portfolio management by applying the principles and methods of Earned Value Management (EVM) to achieve greater savings, better results and improved customer service levels.

### ACHIEVING RESULTS FOR THE AMERICAN PEOPLE

The Federal government continues to make progress by maximizing its, IT investments to deliver program results through the adoption of electronic government management principles and best practices. Departments and agencies continue to focus 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.

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 of the Clinger-Cohen Act of 1996. 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](http://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 (E-Government) initiative. For example, each IT investment must have specific performance targets tied to a specific, significant, beneficial impact for our citizens. Performance functions must be defined, valued and deliver measurable results.

The Federal departments and agencies continue to improve in their efforts to guarantee the success and results for the taxpayer. There were 263 major investments representing about \$10 billion on the "Management Watch List," i.e., those IT investment justifications needing improvement in performance measurement, earned value management or system security. Before the start of the fiscal year, agencies were directed to remediate the shortfalls identified prior to expending additional funds. The agencies have worked to remediate the weaknesses or have put measures in place to monitor the progress of the IT investment which could include multiple projects. If an investment is still on the "Management Watch List," agencies must describe their plans to manage or mitigate risk before undertaking or continuing activities related to that in-

vestment. As of December 31, 2006, 81 percent of the agencies (22 of 27) had all acceptable FY 2007 business cases. Thus, remaining on last year's Management Watch list, there were 84 business cases valued in FY 07 at \$4.3 billion from five agencies. This year, 346 of the 840 FY 2008 major IT investments are on the "Management Watch List." These investments still need to address performance measures, implementation of earned value management, security or other issues before obligating funding in Fiscal Year 2008. See Table 9-3, "Agencies with IT Investments on the Management Watch List."

The Report on Information Technology (IT) Spending for the Federal Government (Exhibit 53) will be published in the spring of 2007 and is located at [www.whitehouse.gov/OMB](http://www.whitehouse.gov/OMB). It provides details of the Administration's proposed 2008 IT investments. Related documents on IT security and Electronic Government (E-Government) are also available at [www.whitehouse.gov/OMB](http://www.whitehouse.gov/OMB).

Fiscal Year 2008 proposed IT investments were analyzed for trends and potential duplications across government entities. At about \$65 billion, the Fiscal Year 2008 Federal IT portfolio represents a 3 percent increase over Fiscal Year 2007 President's Budget. The following represents the highlights:

	FY 2006	FY 2007	FY 2008	Percent Change <sup>1</sup>
Major IT Investments .....	1,087	857	840	-2%
Not Well Planned and Managed .....	358	263	346	32%
Well Planned and Managed .....	682	594	494	-17%

<sup>1</sup> Change from FY 2007 to FY 2008.

The decreasing number of major IT investments is attributed to departments and agencies better managing their Capital Planning and Investment Control (CPIC) process in conformance with their enterprise architectures. The continued maturation of the 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.

With the Administration’s focus on achieving program results, the department and agencies partner with OMB to identify high-risk projects (those IT projects requiring special attention from oversight authorities and/or the highest level of agency management) and report on the agreed upon list of projects quarterly to OMB. As a result, oversight authorities and agency management now have available quarterly data on the progress of these projects to ensure improved execution and performance. OMB is working with departments and agencies to implement corrective action plans in cases where a project did not meet one or more of the four principle criteria. Additional information about high-risk projects including agency performance for FY07Q1 can be found at: [www.whitehouse.gov/omb/egov/b-1-information.html#io](http://www.whitehouse.gov/omb/egov/b-1-information.html#io).

When duplication across Federal agencies has been identified, the Administration has an ongoing process 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 existing 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. The following are the current LoB initiatives underway:

- Case Management;
- Federal Health Architecture;
- Financial Management;
- Human Resources Management;
- Grants Management;
- Information System Security;
- Budget Formulation and Execution;
- IT Infrastructure; and
- Geospatial.

The inter-agency taskforces have driven significant accomplishments for each LoB initiative. The Information System Security (ISS) LoB evaluated agency proposals to become shared service centers in the areas of security awareness training and Federal Information Security Management Act (FISMA) reporting. On the basis of the evaluation and recommendations, the following agencies were selected to be the initial shared service centers:

- Security Awareness Training:
  - Office of Personnel Management
  - Department of State/United States Agency for International Development
  - Department of Defense
- FISMA Reporting:
  - Environmental Protection Agency

—Department of Justice

Accomplishments of this LoB and the remaining LoB initiatives as well as the next steps are included in Table 9–5, “Lines of Business (LoB) Update.”

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 2006, the Federal Government has achieved cost avoidance of over \$300 million for the Oracle agreement alone. The SmartBUY Office located at the General Services Administration (GSA) continues to manage a total of nine agreements. In December 2006, the Administration established an agreement with the first of several Antivirus software developers with projected cost avoidance of as much as \$18 million annually compared with the current best pricing available on GSA schedule and projected agency buying patterns. SmartBUY will continue to identify and develop new agreements throughout the year. In particular, SmartBUY will pursue a multiple award agreement in support of OMB policy memorandum, M-06–16, “Protection of Sensitive Agency Information,” which would include data at rest and remote access.

*Government IT Workforce.*—With rapid advances in IT, improved program performance is first and foremost driven by the Federal employees who manage the IT projects and portfolios. Qualified project managers and an IT workforce with the necessary skills and competencies help ensure agency investments are well planned and managed. In 2005, agencies submitted plans to OMB for closing critical IT skill and competency gaps. Progress against these plans is measured and included in the President’s Management Agenda Human Capital Scorecard. As of September 30, 2006, out of the 26 scorecard agencies:

- 17 agencies (65 percent) have met all planned skill or competency gap closure milestones; and
- 15 agencies (58 percent) have met or are consistently meeting their IT hiring targets.

The table below provides a summary of agency progress toward hiring goals.

Job Area	Fiscal Year 2006—Total Number of Current Positions <sup>1</sup>	Number of Vacant Positions Agencies Planned to Fill by the End of Fiscal Year FY 2006
IT Project Management .....	4,619	600
IT Security .....	9,030	488
IT Architecture (Enterprise) .....	1,169	180
IT Architecture (Solutions) .....	942	148
<b>Total .....</b>	<b>15,760</b>	<b>1,416</b>

<sup>1</sup> As of date agencies reported to OMB.

Agencies have also made progress in assignment of project managers to major IT investments. As reported by agencies on their FY 2008 Exhibit 53 submissions, 83 percent of major IT investments have qualified project managers, an increase from approximately 70 percent in agency FY 2007 submissions.

Going forward, agencies are completing a new IT Workforce Assessment Survey developed and administered by the Chief Information Officers (CIO) Council. The survey collects information from Federal IT professionals about the types of work they perform, as well as their level of proficiency in competencies and skills. The survey also identifies top training needs; gathers information on the types of certifications owned by employees; and provides key demographic data. Using the survey results, agencies will prepare a gap analysis report and improvement plan. OMB will be working in conjunction with OPM and the CIO Council to review the survey results as well as the agency plans to address identified gaps.

*Securing Government Systems.*—The Federal government continues to improve information security performance; however, declines in a few agencies have resulted in a net decrease in overall performance in some areas. Additionally, aspects of IT security such as securing data on removable media remain under addressed government-wide. Departments and agencies progress against their corrective actions plans will be measured in the President’s Management Agenda Expanded Electronic Government Scorecard. On balance, the majority of agencies continue to improve or sustain high performance. Agencies report quarterly on their efforts to address IT security weaknesses against key IT security performance measures.

The 2006 agency FISMA reports reveal continued progress in the area of system certification and accreditation. In FY 2006, the percentage of certified and accredited systems rose from 85 percent to 88 percent, despite a 3 percent increase in the total system inventory to 10,600 operational systems. A few larger agencies made exceptional progress in closing the gap on certification and accreditation and testing of security controls and contingency plans. The State Department and Department of Homeland security both more than doubled their percentage of secured systems. Several departments achieved impressive increases in the percentage of systems with tested security controls and/or contingency plans, most notably Homeland Security, the Department of Housing and Urban Development, the Department of Defense, Department of Energy, Education, and the General Services Administration.

Overall quality of the certification and accreditation processes as determined by agency Inspectors General (IG) decreased slightly compared to 2005, with 60 percent of agencies reporting “satisfactory” or better processes. Over 72 percent of agencies can demonstrate they have an effective process in place for identifying and correcting weaknesses, a slight decrease from 2005.

The overall security status and progress in percentage of systems, from FY 2002 to FY 2006, is as follows:

	(In Fiscal Years)				
	2002	2003	2004	2005	2006
Effective Security and Privacy Controls (C&A) .....	47%	62%	77%	85%	88%
Tested Contingency Plans .....	35%	48%	57%	61%	88%
Tested Security Controls .....	60%	64%	76%	72%	77%
Total Systems Reported .....	7,957	7,998	8,623	10,289	10,600

The number of agencies where the IG has verified the process exists to remediate IT security weaknesses (Plan of Actions & Milestones):

FY 2002 .....	N/A (was not required in until FY 2003)
FY 2003 .....	12
FY 2004 .....	18
FY 2005 .....	19
FY 2006 .....	18

Government-wide, incremental progress in resolving fundamental IT security weaknesses has been made in many aspects of information security; however departments and agencies must continually assess the risks associated with technological developments and service offerings. Thus, each year brings new challenges and approaches, and potentially new measures for performance. 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, 2007, and will be made available on OMB’s website.

*Protecting Privacy.*—In 2006, several agencies experienced high profile data security breaches involving personal information. Most notable of these was the Department of Veterans Affairs, but significant problems also exist at other departments and agencies. Virtually all of these incidents resulted from “internal” problems within agencies and not external attacks on agency systems.

To help address this issue, in May 2006, the President signed an Executive Order creating the Federal Identity Theft Task Force. Several of the Task Force’s interim recommendations address the need to improve data security in the government, improve the agencies’ ability to respond to data breaches, and reduce the risk to personally identifiable information.

In this context, OMB has issued four security and privacy policy and advisory memoranda. These memoranda reemphasize agency responsibilities under law and policy regarding protection and safeguard of sensitive personally identifiable information, including information accessed through removable media, and incident reporting. They are included in Table 9–2, “Management Guidance,” and are available at: [www.whitehouse.gov/OMB/memoranda](http://www.whitehouse.gov/OMB/memoranda).

To help ensure safeguard of personally identifiable information, agencies are required to report on several performance metrics related to information privacy. Additionally, this year agencies were also required to provide quantitative performance measures to assess the privacy of agencies’ personally identifiable information. The FY 2006 agency FISMA reports reveal modest suc-

cess in meeting several key privacy performance measures:

- *Program Oversight.* In 2006, the majority of agencies report having appropriate oversight over their privacy programs in place. All agencies report having a privacy official who participates in privacy compliance activities, however, 84 percent report coordinated oversight coordination with the Office of the Inspector General (OIG). Most agencies report privacy training for Federal employees and contractors, with 92 percent reporting general privacy training and 84 percent reporting job-specific privacy training.
- *Privacy Impact Assessments.* In 2006, 82 percent of applicable systems government-wide have publicly posted privacy impact assessments versus the goal of 90 percent.
- *System of Records Notices (SORNs).* In 2006, 82 percent of systems government-wide with personally identifiable information contained in a system of records covered by the Privacy Act have developed, published, and maintained current systems of records notices versus the goal of 90 percent.

*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. In October 2006, agencies met the major milestone of their HSPD-12 implementation plans which was to begin issuance of compliant identification cards. During FY2007—FY2008, agencies are required to complete issuance of these IDs to all applicable employees and contractors and install infrastructure to use them.

*Initiative for Improving Government Networking Capabilities.*—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 IPv6-capable. In August 2005, OMB issued guidance to agencies 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, in February 2006, the Administration began using the Enterprise Architecture (EA) Assessment Framework to evaluate agency IPv6 transition planning and progress. The agencies are responsible for a series of actions by specific dates. For instance, by June 30, 2006, agencies were to complete:

- an inventory of existing routers, switches, and hardware firewalls; and

—an impact analysis of fiscal and operational impacts and risks.

Agencies are required to submit status reports with their quarterly EA submissions showing progress against the agency-specific milestones detailed in their IPv6 transition plans.

To avoid unnecessary costs in the future, agencies are also required to the maximum extent practicable, to ensure all new IT procurements are IPv6 compliant. Any exceptions to the use of IPv6 require the agency’s CIO to give advance, written approval. In support of this requirement, the National Institute of Standards and Technology (NIST) will release a standards profile. The profile will be released for public comment in January 2007.

Additionally, the President’s National Strategy to Secure Cyberspace directed the Secretary of Commerce to form a task force to examine the most recent iteration of the Internet Protocol, IP version 6 (IPv6). The President charged the task force with considering a variety of IPv6-related issues, “including the appropriate role of government, international interoperability, security in transition, and costs and benefits.” The task force, co-chaired by the Administrator of the National Telecommunications and Information Administration (NTIA) and the Director of the NIST, prepared a report discussing the benefits and impacts of IPv6. This report was published in January 2006.

*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 in whole or in part 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.

GSA’s Office of Citizen Services and Communications manages the operations of FirstGov.gov and recently upgraded their search capability and changed its name to USA.gov in order to improve public access to Federal government information.

An interagency “web content” working group, sponsored by GSA, regularly hosts training for Federal agency webmasters and public affairs officers. Recent courses provided instructions for making agency websites more effective and relevant to popular search engines. Additionally, a web content working group maintains [www.webcontent.gov](http://www.webcontent.gov), conducts interagency meetings to assist agencies in managing their websites, and exchanges best practices among other agencies. These activities support agency efforts to provide access to and dissemination of government information to the public. GSA plans to complete the online tutorial by April 2007. This service will complement other services at USA.gov and elsewhere to aid the public in locating government information.



## SUCCESSFULLY USING ELECTRONIC GOVERNMENT

The departments and agencies continue to leverage information technologies to make government services available to citizens 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 will far outweigh the cost of implementation. 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 and made available on line at [www.egov.gov](http://www.egov.gov).

Examples of how the tenets of E-Government are helping to deliver services to the citizen and make the government more effective include:

*Department of Commerce.* The Online Positioning User Service (OPUS) transforms how users of global positioning systems obtain highly accurate geographic coordinates and elevation data (see: [www.ngs.noaa.gov/OPUS/](http://www.ngs.noaa.gov/OPUS/)). The system allows users, such as professional surveyors, to electronically submit geospatial information via the Internet to the Department, where data are processed to determine corresponding three-dimensional positional coordinates. As a result, the Department is able to provide access to and disseminate more accurate and quality geospatial information to the public. For example, construction, transportation, and mapping industries reduce surveying time and costs (estimated \$270 million cost savings to the public) of creating specific maps and other products needed to operate their business to a fraction of those previously reported.

User forums and workshops to obtain feedback are held regularly across the country, and usage of the system has grown from 1,000 data submissions per month in 2002, to over 13,000 per month in 2006. Extensive interaction between the National Oceanic and Atmospheric Administration (NOAA) and system users takes place during these sessions, and NOAA is currently identifying and surveying representatives from individual counties to ensure their diverse needs are being met. Additionally, users can complete an online survey to provide the Department comments and suggestions on how to improve the system and related positioning products and services. OPUS users include more than 175 organizations, including other Federal agencies, state and local governments, universities, the private sector, foreign governments, and others who share the goal of making more accurate positioning available worldwide. Users without Internet access and

those with disabilities can mail their GPS observations to NOAA on a compact disk and receive the results back via the same mechanism on a prearranged basis.

*U.S. Department of Agriculture.* The Animal and Plant Health Inspection Service (APHIS) launched its new electronic permitting system (ePermits) on April 3, 2006. The system allows customers to apply for a permit, check its status, and view it online. The ability to submit applications and receive permits via the Internet and in some cases the ability to pay applicable permit application fees online, saves customers and APHIS the time and effort associated with the paper-based process. Additional information on system features can be found on the Web site at [www.aphis.usda.gov/permits/](http://www.aphis.usda.gov/permits/).

To successfully implement the system, USDA demonstrated a desire to team with customers, state officials, and peer agencies by facilitating outreach sessions and customer tests. USDA continues to maintain ongoing dialogue with system developers, users, partners, and stakeholders to plan and implement additional features. Customers without Internet access at their facility can still use the paper permit application process and USDA developed the system to be compliant with Section 508 of The Rehabilitation Act of 1998.

Previously, the permit processing workload was growing to become unmanageable with current staff and resources. By eliminating the cost of processing paper and automating the system, more efficiency will result, with benefits to the Federal Government, state governments, and the general public estimated at \$1.2 million per year in the first full year of operating the system. APHIS estimated that when the system is fully deployed it will cut in half the time it takes to process applications to import enterable plants and timber when the applications are entered online. In addition, the system will make it more difficult to tamper with a permit because the system provides immediate access to information relating to applications and permits.

The Administration continues the focus of the department and agency specific services movement to citizen-centered services. Overall funding for the President's E-Government initiatives has reduced annually since Fiscal Year 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. Table 9-4, "Status of the Presidential E-Government Initiatives," included on the CD-ROM, provides an update for each project.

## CONTINUING TO ACHIEVE RESULTS

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 2008 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 man-

agement 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 Federal Government has huge potential and opportunities for growth and to ensure program success and results through the effective use of information technology. Each department and agency will leverage existing capabilities to the maximum potential while ensuring reliability, security, privacy and continuity of services. The institution of the management practices within each department and agency and throughout the government will ensure these results.

## 10. FEDERAL DRUG CONTROL FUNDING

**Table 10–1. Federal Drug Control Funding, FY 2006–2008 <sup>1</sup>**

(Budget authority, in millions of dollars)

Department/Agency	Estimate		2008 Request
	2006	2007	
<b>Department of Defense</b> .....	1,086.6	1,073.9	936.8
<b>Department of Education</b> .....	489.8	524.8	275.0
<b>Department of Health and Human Services:</b>			
National Institute on Drug Abuse .....	998.9	1,000.0	1,000.4
Substance Abuse and Mental Health Services Administration .....	2,440.9	2,442.5	2,360.4
<b>Total HHS</b> .....	3,439.7	3,442.5	3,360.7
<b>Department of Homeland Security:</b>			
Customs and Border Protection .....	1,635.3	1,874.6	1,970.3
Immigration and Customs Enforcement .....	382.3	422.8	450.2
U.S. Coast Guard .....	1,225.5	1,140.2	1,073.2
<b>Total DHS</b> .....	3,243.1	3,437.6	3,493.7
<b>Department of Justice:</b>			
Bureau of Prisons .....	62.6	65.1	67.2
Drug Enforcement Administration .....	1,890.8	1,876.0	2,041.8
Interagency Crime and Drug Enforcement .....	483.2	485.1	509.2
Office of Justice Programs .....	238.2	227.8	178.9
<b>Total Department of Justice</b> .....	2,674.9	2,654.0	2,797.0
<b>ONDCP:</b>			
Counterdrug Technology Assessment Center .....	29.7	19.6	5.0
Operations .....	26.6	26.0	23.9
High Intensity Drug Trafficking Area Program .....	224.7	225.3	220.0
Other Federal Drug Control Programs .....	193.0	194.0	224.5
<b>Total ONDCP</b> .....	474.0	464.9	473.4
<b>Department of State:</b>			
Bureau of International Narcotics and Law Enforcement Affairs .....	1,036.0	1,011.2	783.7
Economic Support Assistance .....	120.9	84.0	313.1
<b>Total Department of State</b> .....	1,156.9	1,095.2	1,096.8
<b>Department of Treasury:</b>			
Internal Revenue Service .....	55.0	55.0	57.3
<b>Department of Veterans Affairs:</b>			
Veterans Health Administration .....	376.7	376.6	392.0
<b>Other Priorities <sup>2</sup></b> .....	2.6	3.7	78.7
<b>Total Federal Drug Budget</b> .....	<b>\$12,999.2</b>	<b>\$13,128.1</b>	<b>\$12,961.4</b>

<sup>1</sup> Detail may not add due to rounding.

<sup>2</sup> Includes (1) the Small Business Administration's Drug-Free Workplace grants, (2) the Department of Transportation National Highway Traffic Safety Administration's Drug Impaired Driving Program, and (3) for FY 2008, Screening and Brief Intervention reimbursement by the Department of Health and Human Services' Centers for Medicare and Medicaid Services.



## 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 moni-

toring 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 estimated 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 1998-2008  
(Dollars in millions)

	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Bureau of Reclamation .....	153.368	114.672	138.507	79.748	103.320	74.212	75.738	81.104	99.828	84.075	84.073
Corps of Engineers .....	100.686	103.341	93.786	54.192	58.227	57.827	72.644	52.306	91.285	76.980	29.755
Natural Resources Conservation Service .....		14.543	12.845	16.945	39.078	38.998	48.745	36.393	34.635	31.937	36.000
National Oceanic and Atmospheric Administration .....	0.300	0.375	0.450	0.550	0.575	0.775	0.775	0.775	0.775	0.500	0.525
Geological Survey .....	3.158	3.158	4.319	5.366	5.089	5.089	4.910	5.419	5.177	4.078	3.814
Fish and Wildlife Service .....	0.941	1.143	3.647	18.230	5.605	11.189	13.684	8.914	10.744	1.483	1.483
Environmental Protection Agency .....	3.204	3.049	57.262	53.375	54.255	20.693	62.780	97.652	32.324	0.533	<sup>1</sup> N/A
<b>Total .....</b>	<b>\$261.657</b>	<b>\$240.281</b>	<b>\$310.816</b>	<b>\$228.406</b>	<b>\$266.149</b>	<b>\$208.783</b>	<b>\$279.276</b>	<b>\$282.563</b>	<b>\$274.768</b>	<b>\$199.59</b>	<b>\$155.650</b>

<sup>1</sup> Estimate not available.



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## ECONOMIC ASSUMPTIONS AND ANALYSES

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## 12. ECONOMIC ASSUMPTIONS

By the end of 2006 the U.S. economy had entered its sixth year of expansion, with a moderate pace of economic growth, sustained increases in payroll jobs, relatively low levels of unemployment and underlying inflation, and good prospects for steady, sustained growth ahead.<sup>1</sup> The ongoing solid economic performance of recent years demonstrates the resilience of the U.S. economy and the beneficial effects of successful pro-growth policies, including tax relief, Federal Reserve monetary policy actions, and ongoing efforts to promote investment in innovative technologies and to liberalize international trade.

The performance of the past five years reveals the robust nature of the U.S. economic expansion and the ability of the economy to overcome a series of shocks, including: sharp declines in the stock market and in investment in business equipment that led to the economic slowdown and recession of 2000–2001; the terrorist attacks of September 11, 2001; the onset of the Global War on Terror; high and increasing prices for crude oil and energy in recent years; and the substantial damage and disruptions from the 2005 hurricane season. Further, during 2006, the U.S. economy began to experience adverse effects from a housing market slowdown. Despite these unfavorable events, the U.S. economy has continued to expand, with solid productivity and income growth, low unemployment, and the generation of more than 7.2 million payroll jobs since August 2003 (including revisions).

As 2007 begins, the Administration and other public and private forecasters expect the expansion to continue throughout the budget window, with sustained non-inflationary real growth providing a solid foundation for the Federal budget outlook.

### Recent Economic Performance

At the time of the preparation of the Budget, real gross domestic product (GDP) in the U.S. economy has been increasing for 20 consecutive quarters, averaging 3.0 percent growth at an annual rate during the expansion. Over the four quarters of 2006, real GDP growth was on track to register about a 3.1 percent growth rate, following the same pace during 2005 and a 3.4 percent rate during 2004.

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 growth in real output in recent years.

- In labor markets, nonfarm payroll employment has increased by more than 7.2 million jobs since the post-recession low in August 2003, with about

2.0 million of those job gains occurring during 2006.

- Reflecting the improved labor situation, the unemployment rate was down to 4.5 percent in December 2006 from its post-recession high of 6.3 percent in June 2003—and recently has been at its lowest level in five years, and at levels below the averages of each of the past five decades.
- Labor productivity gains—the increase in output per hour of labor—have been remarkably strong during the expansion, providing a substantial boost to growth in real GDP. Output per hour in the nonfarm business sector has increased at a 3.0 percent average annual rate over the past five years, although at a slower 2.5 percent pace since the spring of 2003, reflecting the return to stronger employment growth.
- The productivity gains during the expansion reinforce the stronger trend productivity performance of the past decade. Since 1995, labor productivity in the nonfarm business sector has increased at about a 2.8 percent annual rate, double the 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 rising wages and increasing standards of living for American workers and families.

- Reflecting labor gains from stronger productivity growth, during 2006 real hourly earnings of production workers rose by 1.7 percent, the strongest annual gain in five years.
- Through November, real disposable personal income had increased by 3.0 percent at an annual rate during 2006, and the real per capita increase was at a 2.0 percent rate. By way of comparison, during the current expansion real disposable personal income per capita is up 9.7 percent, compared with the 6.7 percent increase during the equivalent period of the prior expansion of the 1990s.

Other economic indicators also provide evidence for the sustained growth performance of the U.S. economy in recent years and during 2006:

- Through the third quarter of 2006, real consumer spending had increased at a 3.4 percent annual rate, following increases at a 2.9 percent rate during 2005 and at a 4.0 percent rate during 2004. In the fourth quarter, consumption spending growth continued, providing a strong base for final demand in the economy at the end of the year.

<sup>1</sup>Economic performance is discussed in terms of calendar years. Budget figures are in terms of fiscal years.

- Real fixed business investment in structures showed strong gains in 2006, rising at a 15 percent annual rate through the third quarter of the year, on track to being the strongest annual increase in more than two decades.
- Real business investment in durable equipment and software increased by 7.1 percent at an annual rate through the third quarter of 2006, following the increases of 7.0 percent during 2005 and 8.3 percent during 2004.
- Real net exports improved during the year as real exports grew by 9.0 percent at an annual rate through the third quarter of 2006—on track to being the strongest performance in 10 years.

Although the underlying trend performance of the U.S. economy has been good and the gains have translated into solid growth of output, incomes, wages, and accumulating wealth, the economy continues to face important challenges—some new, some ongoing including:

- *The housing market* and residential investment activity generally slowed sharply during 2006, subtracting significantly from real GDP growth as the year went on. Housing starts peaked at an annual rate of more than 2.2 million units early in the year, but fell back to about a 1.5 million to 1.6 million annual pace near the end of the year—the lowest in about 5 years. During 2006, real residential investment spending was on track to subtract about 0.7 percentage point from overall real GDP growth.
- *Manufacturing activity* showed signs of slowing at the end of the summer and into the fall. Industrial production of consumer durables slipped in September and October, reflecting declines in production of motor vehicles, energy products, and residential appliances, furniture, and carpeting. Survey measures of manufacturing activity also showed slowing activity. Even so, manufacturing industrial production rose in December and was 3.3 percent higher than in December 2005.
- *Energy prices*—notably crude oil, natural gas, and gasoline prices—increased sharply over the past five years and continued at relatively high levels during much of 2006. For example, the benchmark price for West Texas Intermediate crude oil increased from under \$20 a barrel in December 2001 to about \$74 a barrel in July 2006. Over the same period, the national average retail gasoline price rose from \$1.09 a gallon to \$2.98 a gallon. Some relief occurred during the second half of 2006 as the price of crude oil fell back to below \$61 a barrel by the end of the year, and the retail gasoline price fell to \$2.34 a gallon.
- *The lingering effects from hurricane damage* presented challenges during 2006 as the economy worked through and rebounded from the adverse effects of the severe 2005 hurricane season. Some of the persisting high energy prices in the first half of the year described above can be attributed

to effects from hurricane damage to key oil, natural gas, and refining facilities.

- *Inflation* initially increased as the rise in energy and gasoline prices contributed to higher inflation rates during 2005 and through the middle of 2006—but price increases began to moderate by the end of 2006. The consumer price index (CPI) rose 2.5 percent during 2006 (December to December), down from a 3.4 percent rate during 2005.
- *Core inflation* rose during the first half of 2006 and then began to subside. Abstracting from volatile food and energy items shows that “core” CPI inflation was 2.6 percent during 2006, up from 2.2 percent during 2005. 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 up at a 2.3 percent annual rate through November, compared to the 2.1 percent rate during 2005.
- *Imbalances in international accounts* persisted during 2006 with the trade deficit at about 6 percent of GDP and the current account deficit at nearly 7 percent of GDP. Even so, the international imbalances actually stabilized over the past year with little effect on real GDP growth—after having risen steadily over the past decade and subtracting 0.6 percentage point per year on average from GDP growth over that time.

The economy continued to grow in the face of these challenges, although growth has slowed somewhat over the past year. Despite the volatility in the overall rate of inflation, underlying inflation remains relatively subdued and was lower during the last six months than earlier in 2006. Meanwhile, expectations of future inflation do not appear to be adversely affecting business or household decisions. In general, despite adverse events and slowing performance in specific sectors, economic performance as a whole during 2006 confirms that the U.S. economy is on track for continued expansion with non-inflationary real growth.

### Policy Background

The fiscal and monetary policies of the past five years have successfully contributed to the current good economic performance. The general fiscal policy outlook—as presented in the President’s Budget—reflects the outlook for sustained expansion in the U.S. economy for the foreseeable future. Looking back, timely tax relief and reductions in interest rates promoted the economy’s recovery from recession and helped the Nation overcome the adverse effects from the variety of shocks it faced. Those policies continue to provide a solid foundation for current and future economic performance.

**Fiscal Policy:** Beginning in 2001, the Administration proposed, and the 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. Key tax relief legislation included:

- *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.
- *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 for three years. 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 also reduced tax rates on dividend income and capital gains and expanded bonus depreciation and small business expensing of equipment purchases.

Additional legislation of recent years has extended tax relief, helping to ensure that key provisions would continue and not expire.

**Monetary Policy and Interest Rates:** As 2007 begins, the Federal Reserve continues to orient monetary policy toward promoting sustained non-inflationary real growth in the U.S. economy. As the expansion strengthened, the Federal Reserve raised the Federal funds rate in a steady series of increases from 1 percent to 5.25 percent. The Federal funds rate remained at 5.25 percent over the second half of 2006. In a recent policy statement, the Federal Open Market Committee stated that “the economy seems likely to expand at a moderate pace on balance over coming quarters... Nonetheless... some inflation risks remain.” The Administration’s forecast for the 3-month Treasury bill rate, presented below, was derived to be consistent with market expectations for the interest rate outlook at the time the forecast was completed.

During 2006, longer-term interest rates, notably the yield on 10-year Treasury notes, remained low by historical standards. The 10-year rate traded as low as 4.3 percent in January and as high as 5.25 percent in June, but it ended the year at 4.7 percent. With the Federal funds rate exceeding 5 percent for most of the year, the low 10-year Treasury yields during the year produced a somewhat inverted structure of interest rates across short- to long-term maturities.

**Trade and Regulatory Policies and Competitiveness Initiatives:** Beyond these budget and monetary policies, the Administration continues to work to advance a comprehensive set of policies to promote the short- and long-term performance of the U.S. economy, including trade and regulatory policies and initiatives aimed at boosting competitiveness in domestic and international markets. Expanding opportunities in international trade and investment is one of the Administration’s top priorities. Efforts continue to negotiate

and implement bilateral, regional, and multilateral agreements to promote international trade and investment with countries around the world. These policies create and expand markets for U.S. exports and strengthen the U.S. economy while also creating new economic opportunities for our trading partners—including helping to alleviate poverty in the developing world and promote democratic reform. The Administration’s American Competitiveness Initiative is targeted at advancing U.S. competitiveness through promoting technological innovation, opening new markets, increasing research in the physical sciences and engineering, and protecting intellectual property. Efforts also continue to streamline and simplify Federal regulations that can hinder economic growth and job creation.

### Economic Projections

The Administration’s economic projections, based on information available as of mid-November 2006, 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 sustained growth, solid jobs growth, low inflation, and relatively low interest rates.

**Real GDP, Potential GDP, and Unemployment Rate:** Real GDP, which is estimated to have increased 3.1 percent in 2006 on a fourth quarter-over-fourth quarter basis, is projected to increase 2.9 percent this year. During the next few years, both actual and potential growth are projected to moderate slightly from 3.1 percent for 2008 to 2.9 percent by 2012. As a result, the unemployment rate, which dipped as low as 4.4 percent late in 2006, is projected to edge up to its sustainable rate of 4.8 percent and 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 most.

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 3.1 percent over the next two years, trending down to 2.9 percent by 2012, primarily because of an assumed slowing in labor force growth. The labor force is projected to grow about 1.0 percent per year through 2008 on average, slowing to about 0.7 percent yearly on average during 2009–2012 as increasing numbers of baby boomers enter retirement.

Table 12-1. ECONOMIC ASSUMPTIONS <sup>1</sup>

(Calendar years; dollar amounts in billions)

	Actual 2005	Projections						
		2006	2007	2008	2009	2010	2011	2012
<b>Gross Domestic Product (GDP):</b>								
Levels, dollar amounts in billions:								
Current dollars .....	12,456	13,248	13,946	14,711	15,507	16,316	17,148	18,003
Real, chained (2000) dollars .....	11,049	11,412	11,721	12,077	12,451	12,827	13,211	13,599
Chained price index (2000=100), annual average .....	112.7	116.1	119.0	121.8	124.6	127.2	129.8	132.4
Percent change, fourth quarter over fourth quarter:								
Current dollars .....	6.4	5.9	5.5	5.5	5.3	5.2	5.0	5.0
Real, chained (2000) dollars .....	3.1	3.1	2.9	3.1	3.1	3.0	3.0	2.9
Chained price index (2000=100) .....	3.1	2.7	2.5	2.3	2.2	2.1	2.0	2.0
Percent change, year over year:								
Current dollars .....	6.3	6.4	5.3	5.5	5.4	5.2	5.1	5.0
Real, chained (2000) dollars .....	3.2	3.3	2.7	3.0	3.1	3.0	3.0	2.9
Chained price index (2000=100) .....	3.0	3.0	2.5	2.4	2.2	2.1	2.0	2.0
<b>Incomes, billions of current dollars:</b>								
Corporate profits before tax .....	1,519	1,779	1,785	1,815	1,839	1,846	1,860	1,879
Wages and salaries .....	5,665	6,115	6,478	6,862	7,248	7,628	8,035	8,454
Other taxable income <sup>2</sup> .....	2,563	2,754	2,949	3,112	3,261	3,404	3,579	3,756
<b>Consumer Price Index: <sup>3</sup></b>								
Level (1982-84=100), annual average .....	195.3	201.7	206.0	211.4	216.8	222.0	227.2	232.5
Percent change, fourth quarter over fourth quarter .....	3.7	2.3	2.6	2.6	2.5	2.4	2.3	2.3
Percent change, year over year .....	3.4	3.3	2.1	2.6	2.5	2.4	2.3	2.3
<b>Unemployment rate, civilian, percent:</b>								
Fourth quarter level .....	5.0	4.5	4.7	4.8	4.8	4.8	4.8	4.8
Annual average .....	5.1	4.6	4.6	4.8	4.8	4.8	4.8	4.8
<b>Federal pay raises, January, percent:</b>								
Military <sup>4</sup> .....	3.5	3.1	2.7	3.0	NA	NA	NA	NA
Civilian <sup>5</sup> .....	3.5	3.1	2.2	3.0	NA	NA	NA	NA
<b>Interest rates, percent:</b>								
91-day Treasury bills <sup>6</sup> .....	3.1	4.7	4.7	4.6	4.4	4.2	4.1	4.1
10-year Treasury notes .....	4.3	4.8	5.0	5.1	5.2	5.3	5.3	5.3

NA = Not Available.

<sup>1</sup> Based on information available as of mid-November 2006.<sup>2</sup> Dividends, rent, interest and proprietors' income components of personal income.<sup>3</sup> Seasonally adjusted CPI for all urban consumers.<sup>4</sup> Percentages apply to basic pay only; percentages to be proposed for years after 2008 have not yet been determined.<sup>5</sup> Overall average increase, including locality pay adjustments. Percentages to be proposed for years after 2008 have not yet been determined.<sup>6</sup> Average rate, secondary market (bank discount basis).

Trend productivity growth in the nonfarm business sector<sup>2</sup> 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 (3.1 percent per year). It is, however, close to the pace from 1995 through 2000 (2.5 percent) and not far from the 60-year average since the official productivity series began in 1947 (2.3 percent).

**Inflation:** Inflation moderated in 2006, in large part because of declining energy prices. With the recent easing of these prices, inflation is likely to be lower in 2007. On a year-over-year basis, the CPI is projected to increase 2.1 percent this year but to rebound to 2.6 percent in 2008, with the increase moderating to 2.3 percent a year through 2012. This inflation rate is lower than the average during each decade of the 1970s, 1980s, and 1990s. The GDP price index is pro-

jected to increase 2.5 percent in 2007, moderating to 2.0 by 2011 and 2012, slightly less than CPI inflation, which is the usual pattern.

The forecast of low inflation reflects the current very low core inflation rate, falling energy prices, modest inflation expectations, the downward pressure on inflation due to both domestic and global competition, and the Federal Reserve's monetary policy.

**Interest Rates:** Short-term interest rates are projected to decline somewhat and long-term rates to rise slightly, achieving a more normal yield curve spread. The 3-month Treasury bill rate, which was 4.9 percent at the end of December, is expected to decrease to 4.1 percent by 2011. The yield on the 10-year Treasury note, 4.7 percent at the end of last year, is projected to increase to 5.3 percent by 2010.

The forecast rates are historically low: the projected averages for 3-month and 10-year Treasuries during 2007-2012 are lower than the averages for these instruments during each decade of the 1970s, 1980s, and

<sup>2</sup>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 sector of reference for productivity because of its reliable measurement.

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 2006, while the share of corporate profits is projected to decline from the unusually high levels of 2006 and those anticipated for 2007. In recent years, growth of hourly compensation adjusted for inflation has lagged the growth of productivity. During the projection period, however, real hourly 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 2006.

Corporate profits before tax jumped sharply as a share of GDP in 2005 and 2006 in part due to 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. Since 2004, however, corporate profits before tax have been higher than normal both because new investment has not qualified for the temporary acceleration and because the remaining depreciation permitted on 2003 and 2004 investment that used this provision has been thereby reduced.

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. Personal dividend income's share, too, is projected to decline, reflecting the declining profit share. A slight rise is projected for proprietors' income, while the remaining share of the tax base, rental income, is projected to remain relatively stable at around its 2006 level.

### 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 Department, the Council of Economic Advisers, and the Office of Management and Budget. Private-sector forecasts are often used by businesses for current decision-making and in long-term planning, and the "consensus" or average serves as a useful benchmark for comparison. Table 12-2 compares the 2008 Budget assumptions with projections as of January 2007 by CBO and by the Blue Chip Consensus, an average of about 50 private-sector forecasts.

The three sets of economic assumptions are based on different underlying assumptions concerning eco-

nomical 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. The 50 or so private forecasters in the Blue Chip Consensus make differing policy assumptions. 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 moderate growth this year. The Administration projects 2.7 percent growth on a year-over-year basis, slightly higher than either the Consensus or CBO's forecast, which are 2.4 percent and 2.3 percent, respectively. For calendar year 2008, the Administration, CBO, and the Consensus all forecast 3.0 percent real growth. The three forecasts are in agreement in both 2009 (3.1 percent) and 2010 (3.0 percent). In 2011 and 2012, the Administration's projection is about the same as the Consensus growth rate but CBO's is slightly lower. Over the six-year span as a whole, the Administration, CBO and the Consensus all project average annual growth rates in a narrow range of 2.8 to 3.0 percent.

All three forecasts anticipate continued low inflation in the range of 1.8 to 2.5 percent as measured by the GDP price index; and, after 2007, between 2.2 and 2.6 percent as measured by the CPI, with CBO lower than the Administration and the Consensus, which are close to each other. The three unemployment rate projections are also similar with projected rates in the narrow range of 4.8 percent to 5.0 percent after 2007. All three project slightly falling short-term interest rates and a slight rise in long-term rates during the next few years, with the Administration's short-term rates slightly below the Blue Chip's and CBO's, and the long-term rate forecasts nearly identical.

### Changes in Economic Assumptions

The economic assumptions underlying this Budget for 2008 are similar to those of the 2007 Budget, as shown in Table 12-3.

Real GDP growth is now expected to be 2.7 percent in 2007, 3.0 percent in 2008, and 3.1 percent in 2009 on a year-over-year basis, moderating gradually to 2.9 percent by 2012. In comparison, last year's Budget projections showed 3.3 percent real growth for both 2007 and 2008, moderating to 3.0 percent by 2012. Despite the lower real growth forecast this year, the level of nominal GDP is now projected to be higher than in the 2007 Budget projection because of a faster-than-expected rise in the GDP price index last year and slightly higher projected GDP inflation in the next few years.

The unemployment rate projection has been adjusted slightly, reflecting a new assessment of the "natural

Table 12-2. COMPARISON OF ECONOMIC ASSUMPTIONS

(Calendar years)

	Projections						Average, 2007–12
	2007	2008	2009	2010	2011	2012	
<b>GDP (billions of current dollars):</b>							
2008 Budget .....	13,946	14,711	15,507	16,316	17,148	18,003	
CBO January .....	13,805	14,472	15,196	15,923	16,647	17,395	
Blue Chip Consensus January .....	13,843	14,561	15,323	16,116	16,937	17,805	
<b>Real GDP (chain-weighted):<sup>1</sup></b>							
2008 Budget .....	2.7	3.0	3.1	3.0	3.0	2.9	3.0
CBO January .....	2.3	3.0	3.1	3.0	2.7	2.7	2.8
Blue Chip Consensus January .....	2.4	3.0	3.1	3.0	2.9	3.0	2.9
<b>Chain-weighted GDP Price Index:<sup>1</sup></b>							
2008 Budget .....	2.5	2.4	2.2	2.1	2.0	2.0	2.2
CBO January .....	1.9	1.8	1.8	1.8	1.8	1.8	1.8
Blue Chip Consensus January .....	2.1	2.1	2.1	2.1	2.1	2.1	2.1
<b>Consumer Price Index (all-urban):<sup>1</sup></b>							
2008 Budget .....	2.1	2.6	2.5	2.4	2.3	2.3	2.4
CBO January .....	1.9	2.3	2.2	2.2	2.2	2.2	2.2
Blue Chip Consensus January .....	2.0	2.3	2.3	2.3	2.3	2.4	2.3
<b>Unemployment rate:<sup>2</sup></b>							
2008 Budget .....	4.6	4.8	4.8	4.8	4.8	4.8	4.8
CBO January .....	4.7	4.9	5.0	5.0	5.0	5.0	4.9
Blue Chip Consensus January .....	4.8	4.9	4.9	4.9	4.9	4.9	4.9
<b>Interest rates:<sup>2</sup></b>							
91-day Treasury bills:							
2008 Budget .....	4.7	4.6	4.4	4.2	4.1	4.1	4.4
CBO January .....	4.8	4.5	4.4	4.4	4.4	4.4	4.5
Blue Chip Consensus January .....	4.9	4.8	4.7	4.5	4.5	4.6	4.7
10-year Treasury notes:							
2008 Budget .....	5.0	5.1	5.2	5.3	5.3	5.3	5.2
CBO January .....	4.8	5.0	5.1	5.2	5.2	5.2	5.1
Blue Chip Consensus January .....	4.8	5.0	5.2	5.2	5.2	5.3	5.1

Sources: Congressional Budget Office; Blue Chip Economic Indicators, Aspen Publishers, Inc.

January 2007 Blue Chip Consensus forecast for 2007 and 2008; Blue Chip October 2006 long-run extension for 2009–2012.

<sup>1</sup> Year-over-year percent change.<sup>2</sup> Annual averages, percent.

rate” consistent with stable inflation. While the 2007 Budget had the rate level at 5.0 percent in future years, the rate is now projected to stabilize at 4.8 percent in the outyears. The 3-month Treasury bill rate is expected to trend downward, ultimately to the same level, 4.3 percent, as before. The 10-year Treasury note rate is now projected to rise to 5.3 percent by 2010, lower than the previous assumption that it would reach 5.6 percent.

### Structural and Cyclical Balances

Historically, a budget measure called the structural balance has provided an alternative perspective on the stance of fiscal policy as compared to the unadjusted budget balance which includes a component related to the cyclical performance of the economy. For example, when the economy operates below potential, the unemployment rate exceeds the long-run sustainable average consistent with price stability. As a result, receipts are lower and outlays for unemployment-sensitive programs (such as unemployment compensation and food stamps) are higher; the deficit is larger (or the surplus smaller) than 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 of the deficit that remains when the unemployment rate is at its long-run value is then called the structural deficit (or structural surplus). In the typical post-World War II business cycle, the structural balance has provided a gauge of the surplus or deficit that would persist if the economy were 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

**Table 12-3. COMPARISON OF ECONOMIC ASSUMPTIONS IN THE 2007 AND 2008 BUDGETS**

(Calendar years; dollar amounts in billions)

	2006	2007	2008	2009	2010	2011	2012
<b>Nominal GDP:</b>							
2007 Budget assumptions <sup>1</sup> .....	13,192	13,931	14,693	15,473	16,288	17,154	18,059
2008 Budget assumptions .....	13,248	13,946	14,711	15,507	16,316	17,148	18,003
<b>Real GDP (2000 dollars):</b>							
2007 Budget assumptions <sup>1</sup> .....	11,433	11,813	12,198	12,580	12,970	13,373	13,779
2008 Budget assumptions .....	11,412	11,721	12,077	12,451	12,827	13,211	13,599
<b>Real GDP (percent change):<sup>2</sup></b>							
2007 Budget assumptions .....	3.4	3.3	3.3	3.1	3.1	3.1	3.0
2008 Budget assumptions .....	3.3	2.7	3.0	3.1	3.0	3.0	2.9
<b>GDP price index (percent change):<sup>2</sup></b>							
2007 Budget assumptions .....	2.4	2.2	2.1	2.1	2.1	2.1	2.2
2008 Budget assumptions .....	3.0	2.5	2.4	2.2	2.1	2.0	2.0
<b>Consumer Price Index (percent change):<sup>2</sup></b>							
2007 Budget assumptions .....	3.0	2.4	2.4	2.4	2.4	2.5	2.5
2008 Budget assumptions .....	3.3	2.1	2.6	2.5	2.4	2.3	2.3
<b>Civilian unemployment rate (percent):<sup>3</sup></b>							
2007 Budget assumptions .....	5.0	5.0	5.0	5.0	5.0	5.0	5.0
2008 Budget assumptions .....	4.6	4.6	4.8	4.8	4.8	4.8	4.8
<b>91-day Treasury bill rate (percent):<sup>3</sup></b>							
2007 Budget assumptions .....	4.2	4.2	4.3	4.3	4.3	4.3	4.3
2008 Budget assumptions .....	4.8	4.9	4.7	4.6	4.4	4.3	4.3
<b>10-year Treasury note rate (percent):<sup>3</sup></b>							
2007 Budget assumptions .....	5.0	5.4	5.5	5.6	5.6	5.6	5.6
2008 Budget assumptions .....	4.8	5.0	5.1	5.2	5.3	5.3	5.3

<sup>1</sup> Adjusted for July 2006 NIPA revisions.<sup>2</sup> Year-over-year.<sup>3</sup> Calendar year average.

market's contribution to receipts is counted in the structural balance.

Other factors unique to the current economic cycle provide additional examples of less-than-complete cyclical adjustment. The fall-off in labor force participation, from 67.1 percent of the U.S. population in 1997–2000 to 66.1 percent in 2004–2006, appears to be at least partly cyclical in nature. 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 underutilized 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 45.3 percent in the second quarter of 2006. Again, this change is widely suspected to be partly cyclical. Since Federal tax collections 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.

**Table 12-4. ADJUSTED STRUCTURAL BALANCE**

(Fiscal years; in billions of dollars)

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Unadjusted surplus or deficit (-) .....	128.2	-157.8	-377.6	-412.7	-318.3	-248.2	-244.2	-239.4	-187.2	-94.4	-53.8	61.0
Cyclical component .....	92.7	-28.7	-70.8	-33.4	-5.5	15.1	8.6	-4.8	-3.1	-0.4	0.0	0.0
Structural surplus or deficit (-) .....	35.5	-129.0	-306.8	-379.3	-312.9	-263.3	-252.8	-234.6	-184.1	-93.9	-53.8	61.0
Deposit insurance outlays .....	1.6	1.0	1.4	2.0	1.4	1.1	2.2	3.4	5.6	5.9	6.1	3.9
Adjusted structural surplus or deficit (-) .....	37.1	-128.0	-305.3	-377.4	-311.5	-262.2	-250.6	-231.2	-178.5	-88.0	-47.7	65.0

NOTE: The NAIRU is assumed to be 4.8% in 2006 and subsequent years, 4.9% in earlier years.

For all these reasons, the current estimates of the cyclical deficit are probably understated. The current unemployment gap is believed to be near 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 year 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 that year 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. Similarly, in 2006 the unemployment rate appeared to be slightly lower than the “natural rate,” rendering the structural deficit for that year slightly higher than the actual deficit, and that effect persists into 2007.

### 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 2007 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 2007

deficit is estimated to increase by \$16.1 billion; receipts in 2007 would be lower by \$13.4 billion, and outlays would be higher by \$2.7 billion, primarily for unemployment-sensitive programs. In fiscal year 2008, the estimated receipts shortfall would grow further to \$27.7 billion, and outlays would increase by \$8.0 billion relative to the base, even though the growth rate in calendar year 2008 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 2007–2012, the cumulative increase in the budget deficit is estimated to be \$243 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 2007–2012, the cumulative increase in the budget deficit is estimated to be \$689 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 2007 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 2007 and 2008, outlays would be above the base by \$10.8 billion and \$18.3 billion, respectively, due in part to lagged cost-of-living adjustments. Receipts would rise by \$23.2 billion in 2007, but then would rise by \$44.5 billion above the base in 2008 due to the sustained effects of the elevated price level on the tax base, and to the temporary effect of higher 2007 interest rates on financial corporations' profits and taxes, resulting in a \$26.1 billion improvement in the 2008 budget balance. In subsequent years, the amounts added to receipts would continue to be larger than the additions to outlays. During 2007–2012, cumulative budget deficits would be \$130 billion smaller than in the base case.
- In the fourth block, 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 \$344 billion to outlays over 2007–2012 and \$834 billion to receipts, for a net decrease in the 2007–2012 deficits of \$490 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 decreases cumulative deficits by a substantial \$445 billion during 2007–2012. 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. Outlays for discretionary programs are assumed to be unchanged in spite of the higher inflation rate. 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	2007	2008	2009	2010	2011	2012	Total of Effects, 2007–2012
<b>Real Growth and Employment</b>							
<b>Budgetary effects of 1 percent lower real GDP growth:</b>							
(1) For calendar year 2007 only: <sup>1</sup>							
Receipts .....	-13.4	-27.7	-31.2	-33.8	-35.6	-37.6	-179.3
Outlays .....	2.7	8.0	10.3	12.3	14.4	16.4	63.9
Increase in deficit (-) .....	-16.1	-35.7	-41.5	-46.1	-49.9	-54.0	-243.3
(2) Sustained during 2007–2017, with no change in unemployment:							
Receipts .....	-13.6	-43.6	-80.4	-123.2	-167.6	-216.2	-644.7
Outlays .....	0.2	1.3	3.8	7.6	13.0	18.8	44.8
Increase in deficit (-) .....	-13.8	-44.9	-84.2	-130.8	-180.6	-235.0	-689.4
<b>Inflation and Interest Rates</b>							
<b>Budgetary effects of 1 percentage point higher rate of:</b>							
(3) Inflation and interest rates during calendar year 2007 only:							
Receipts .....	23.2	44.5	38.4	34.4	36.1	38.2	214.8
Outlays .....	10.8	18.3	15.2	14.1	13.4	12.6	84.4
Decrease in deficit (+) .....	12.4	26.1	23.2	20.4	22.7	25.6	130.4
(4) Inflation and interest rates, sustained during 2007–2017:							
Receipts .....	23.2	71.3	116.5	160.5	206.4	256.5	834.3
Outlays .....	11.2	32.9	52.1	68.6	83.3	96.1	344.1
Decrease in deficit (+) .....	12.0	38.3	64.4	91.9	123.1	160.4	490.1
(5) Interest rates only, sustained during 2007–2017:							
Receipts .....	9.7	28.5	38.7	41.9	45.0	47.4	211.1
Outlays .....	7.7	21.5	31.0	36.6	39.7	41.5	178.0
Increase in deficit (-) .....	2.0	7.0	7.6	5.3	5.2	5.9	33.1
(6) Inflation only, sustained during 2007–2017:							
Receipts .....	13.4	42.7	77.7	118.3	161.0	208.5	621.6
Outlays .....	3.5	11.7	21.9	33.6	46.4	59.0	176.2
Decrease in deficit (+) .....	9.9	31.0	55.8	84.7	114.6	149.5	445.4
<b>Interest Cost of Higher Federal Borrowing</b>							
(7) Outlay effect of \$100 billion increase in borrowing in 2007 .....	2.5	5.1	5.2	5.2	5.3	5.5	28.8

\$50 million or less.

<sup>1</sup> 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. One measure of the Government's performance is the extent to which it collects the taxes that are owed to it, and another is whether it delivers value in spending the taxes that it collects. Both of those questions are addressed below. In general, the Government's 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 as tentative; 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. This part presents information on national economic and social conditions. It begins with an analysis of tax compliance, including what can be done to improve it, and what resources might be made available with new efforts to assure compliance. 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, which are intended to show how the Government's efforts to improve social and economic outcomes might be measured.

### 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 offers a useful way to examine the financial implications of Federal policies. This framework includes information about assets and liabilities such as might appear on a balance sheet, but it also includes long-run projections of the entire budget showing where future fiscal strains are most likely to appear. It includes an analysis of the Government's potential revenue and what can be done realistically through better education and more rigorous enforce-

ment of the tax law to reach that potential. Measures of national wealth, which support future income and tax receipts, are presented along with an array of economic and social indicators showing potential pressure points that may require future policy responses.

The Government's 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 veterans' 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" that would appear on a balance sheet. Until the law is changed, 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 programmatic 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 grows 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 questions of whether the Government is collecting the full amount of taxes owed, whether the public is receiving value for its taxes paid, and whether Federal resources 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 13-7.

### 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.<sup>1</sup>

*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 current presentation is an experimental approach for fulfilling this objective at the Federal 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, which is based on different data

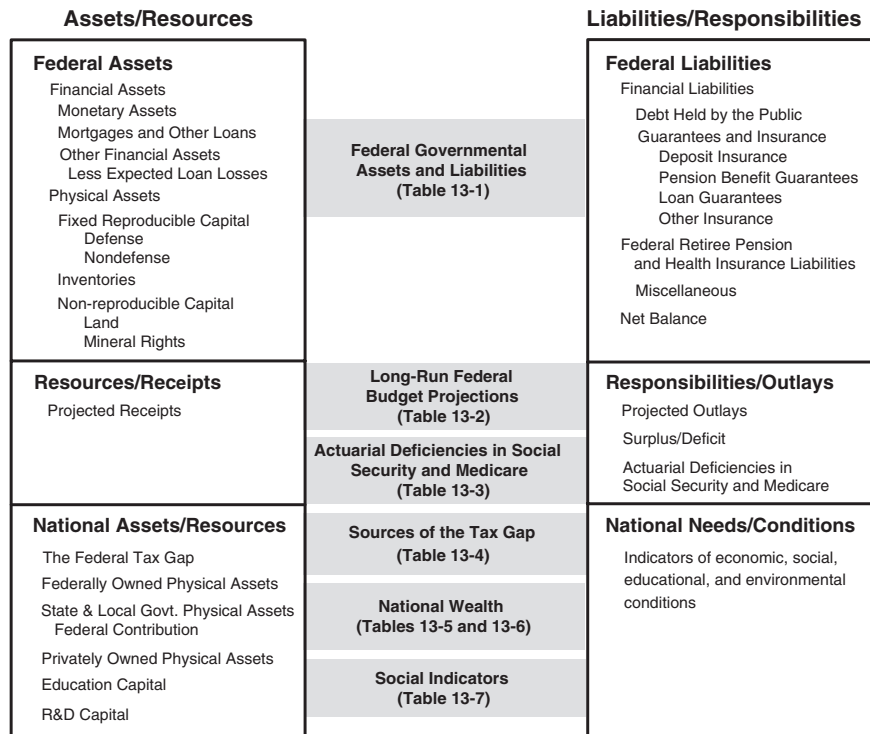
<sup>1</sup> Statement of Federal Financial Accounting Concepts, Number 1, Objectives of Federal Financial Reporting, September 2, 1993. Other objectives are budgetary integrity, operating performance, and systems and controls.

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 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 based on current and proposed laws, the tax gap, 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 cover 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 but 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. Q06

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 future 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 excluding taxes from 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?***

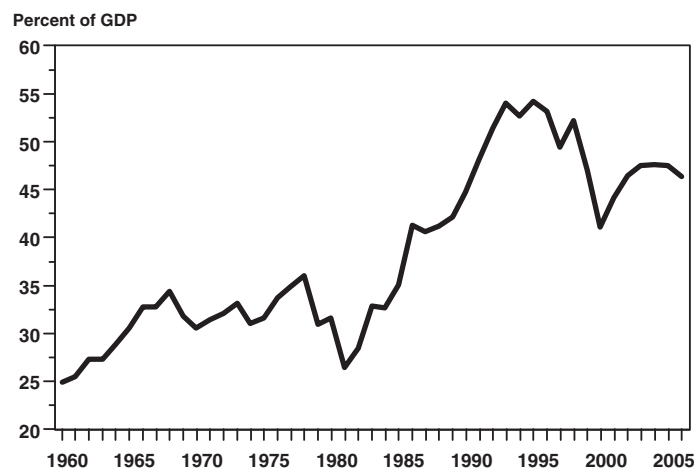
The Government is not a business, and accounting standards designed to illuminate how much a business earns and how much equity it has could provide misleading information if applied naively to the Government. The Government does not have a "bottom line" comparable to that of a business corporation, 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."

## PART II—THE FEDERAL GOVERNMENT'S ASSETS AND LIABILITIES

Table 13-1 looks at the Government's assets and liabilities retrospectively, 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 2006 dollars and the balance is also shown as a ratio to GDP. Govern-

ment 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 79 percent greater than it was in 1960. Meanwhile, Federal liabilities have increased by 246 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 in 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 has also reduced the Government's 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 \$6.2 trillion or about \$20,600 per capita. As a ratio to GDP, the excess of liabilities over assets reached a peak of 54 percent in 1995; it declined to 41 percent in 2000; it rose to 48 percent in 2004; and it has declined slightly since then to around 46 percent of GDP at the end of 2006. The average since 1960 has been 38 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 \$600 billion at the end of 2006. 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 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 \$47 billion as of year-end 2006. 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



**Table 13-1. GOVERNMENT ASSETS AND LIABILITIES\***

(As of the end of the fiscal year, in billions of 2006 dollars)

	1960	1965	1970	1975	1980	1985	1990	1995	2000	2004	2005	2006
<b>ASSETS</b>												
Financial Assets:												
Cash and Checking Deposits .....	48	69	43	35	54	35	47	49	65	38	36	51
Other Monetary Assets .....	2	1	1	2	2	2	2	1	7	2	2	5
Mortgages .....	31	30	44	46	86	88	112	77	89	79	79	81
Other Loans .....	114	157	197	199	255	331	235	190	226	228	218	209
less Expected Loan Losses .....	-1	-3	-5	-10	-20	-19	-22	-28	-43	-50	-42	-47
Other Treasury Financial Assets .....	69	86	76	68	96	142	226	272	248	334	318	302
Subtotal .....	263	341	356	340	474	579	601	562	592	631	610	602
Nonfinancial Assets:												
Fixed Reproducible Capital: .....	1,151	1,142	1,188	1,152	1,092	1,234	1,280	1,287	1,129	1,113	1,138	1,166
Defense .....	992	932	942	861	773	898	922	901	737	702	718	736
Nondefense .....	159	210	246	292	319	336	359	386	392	412	420	430
Inventories .....	301	261	243	217	268	307	272	209	215	277	280	281
Nonreproducible Capital: .....	487	500	480	710	1,139	1,220	964	719	1,078	1,484	1,839	1,896
Land .....	106	147	185	292	374	388	399	297	462	635	764	833
Mineral Rights .....	381	354	295	418	765	832	564	422	616	849	1,076	1,062
Subtotal .....	1,940	1,903	1,911	2,080	2,498	2,762	2,516	2,216	2,422	2,875	3,257	3,343
<b>Total Assets</b> .....	<b>2,202</b>	<b>2,244</b>	<b>2,267</b>	<b>2,419</b>	<b>2,972</b>	<b>3,341</b>	<b>3,117</b>	<b>2,777</b>	<b>3,014</b>	<b>3,505</b>	<b>3,867</b>	<b>3,944</b>
<b>LIABILITIES</b>												
Debt held by the Public .....	1,313	1,351	1,202	1,221	1,519	2,511	3,421	4,547	3,960	4,557	4,725	4,829
Insurance and Guarantee Liabilities:												
Deposit Insurance .....					2	10	82	6	1	1	1	1
Pension Benefit Guarantee .....				50	36	50	50	24	47	93	84	74
Loan Guarantees .....		1	3	7	14	12	18	34	43	46	49	48
Other Insurance .....	36	32	25	23	31	19	23	20	19	19	42	20
Subtotal .....	36	33	28	80	84	92	173	84	110	160	177	143
Pension and Post-Employment Health Liabilities:												
Civilian and Military Pensions .....	992	1,247	1,490	1,689	2,077	2,061	2,014	1,953	1,990	2,128	2,196	2,211
Retiree Health Insurance Benefits .....	238	299	357	405	498	494	483	468	454	1,052	1,157	1,132
Veterans Disability Compensation .....	218	274	328	363	372	307	277	303	642	981	1,155	1,154
Subtotal .....	1,448	1,820	2,175	2,457	2,947	2,862	2,774	2,724	3,085	4,161	4,508	4,497
Environmental and Disposal Liabilities .....	78	96	116	131	158	187	220	287	350	264	267	305
Other Liabilities:												
Trade Payables and Miscellaneous .....	31	38	49	60	94	123	169	140	121	209	217	222
Benefits Due and Payable .....	24	28	38	40	51	57	68	79	90	109	120	129
Subtotal .....	55	66	87	100	145	180	237	219	212	318	337	351
<b>Total Liabilities</b> .....	<b>2,930</b>	<b>3,366</b>	<b>3,608</b>	<b>3,989</b>	<b>4,852</b>	<b>5,832</b>	<b>6,826</b>	<b>7,860</b>	<b>7,717</b>	<b>9,460</b>	<b>10,015</b>	<b>10,125</b>
<b>Net Assets (Assets Minus Liabilities)</b> .....	<b>-727</b>	<b>-1,122</b>	<b>-1,341</b>	<b>-1,570</b>	<b>-1,880</b>	<b>-2,491</b>	<b>-3,709</b>	<b>-5,083</b>	<b>-4,702</b>	<b>-5,955</b>	<b>-6,147</b>	<b>-6,181</b>
<b>Addenda:</b>												
<b>Net Assets Per Capita (in 2006 dollars)</b> .....	<b>-4,032</b>	<b>-5,783</b>	<b>-6,551</b>	<b>-7,279</b>	<b>-8,242</b>	<b>-10,432</b>	<b>-14,802</b>	<b>-19,037</b>	<b>-16,627</b>	<b>-20,234</b>	<b>-20,696</b>	<b>-20,623</b>
<b>Ratio to GDP (in percent)</b> .....	<b>-24.9</b>	<b>-30.6</b>	<b>-30.6</b>	<b>-31.6</b>	<b>-31.6</b>	<b>-35.1</b>	<b>-44.7</b>	<b>-54.2</b>	<b>-41.1</b>	<b>-47.6</b>	<b>-47.5</b>	<b>-46.4</b>

\* This table shows assets and liabilities for the Government as a whole excluding the Federal Reserve System. Data for 2006 are extrapolated in some cases.

amounted to about \$1.2 trillion in constant 2006 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 2.2 percent. The Government also holds inventories of defense goods and other

items that in 2006 amounted to about 24 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 2002–2006. These fluctuations have caused the estimated value of Federal mineral deposits to fluctuate as well. In 2006, as estimated here, the combined real value of Federal land and mineral rights was higher than it has ever been, but only 35 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 four years, and was at an all-time high in 2006. The Government's asset holdings are vast. As of the end of 2006, Government assets were estimated to be worth about \$4 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 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. The Government also has a responsibility to repair environmental damage that resulted from nuclear weapons production, and that cost has been included in the Table as well.

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, 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 \$4.8 trillion at the end of 2006. Publicly held debt declined for several years in the late 1990s because of the unified budget surpluses 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 pay-

ments 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 \$140 billion. 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, these insurance and guarantee liabilities are fairly small relative to total Federal liabilities or even the total debt held by the public. They were less than 2 percent of total liabilities in 2006.

*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 \$4.5 trillion at the end of 2006 up from \$3.1 trillion in 2000.<sup>2</sup> There was a large expansion in Federal military retiree health benefits legislated in 2001.

*Environmental and Disposal Liabilities:* During World War II and the Cold War, the Federal Government constructed a vast industrial complex to study, produce and test nuclear weapons. Environmental contamination occurred at these sites. The estimated liability shown here is based on the cleanup costs required by Federal, State and local laws and regulations. The Department of Energy is responsible for managing this cleanup. The Department of Defense is also charged with cleaning up contamination from its waste disposal practices, leaks, spills and other risky activities. Together the cleanup costs are estimated to amount to around 300 billion dollars in present value.<sup>3</sup>

### 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 2004–2006 they remained lower than at any time from 1965 through 2002. Despite the historically low interest rates, there are limits to how much debt the Government can assume without putting its finances in jeopardy. Over an extended time

<sup>2</sup> Estimates of these liabilities were derived from the Financial Report of the United States Government for 2006 and earlier years. Values for years prior to 1997 were extrapolated.

<sup>3</sup> Estimates of these liabilities were also derived from the Financial Report of the United States Government for 2006 and earlier years. Values for years prior to 1997 were extrapolated.

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.

It is necessary to project the budget into the future to judge the prospects for long-run solvency. That is the subject of the next section.

### 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, 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 entitlement program that provides medical assistance, including acute and long-term care to low-income persons including families with dependent children, as well as aged, blind or disabled individuals. 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 future problems are

often best addressed in the present. 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.

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 account for about two-thirds of non-interest Federal spending even with the reforms proposed in this Budget. At the end of the projection period, in 2080, the figure could rise to around three-quarters of non-interest spending. In other words, 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 expansion of the entitlement programs and the rise in the deficit unfold gradually. The budget deficit is projected to decline as the economy expands over the next several years until it reaches balance in 2012, while most of the baby boomers are still in the work force.

The budget is projected to remain in surplus for some years after 2012, but the deficit eventually returns and then begins a steady increase. Without further 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. There is likely to be a crisis before that point is reached that will force budgetary changes, but the timing of the crisis and its resolution are impossible to predict, and timely, comprehensive entitlement reforms could avoid such a crisis.

The revenue projections start with the budget's estimate of receipts under the Administration's proposals for the next five years. In the long run, receipts are assumed to return gradually to their average as a share of GDP over the last 40 years—18.3 percent.

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.

In past budgets, 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 run, however, their effects would be significant. Because these other reforms are not yet specified, the long-range projections shown here do not incorporate any Social Security reforms. Showing the personal account proposal in isolation would give a distorted picture of the budget effects of comprehensive Social Security reform. An alternative projection, however, that incorporates the impact of personal accounts is shown later in this presentation.

The long-run budget outlook is highly uncertain. 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 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. (For a further discussion of the forecasting assumptions used to make these

**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	18.3	18.3	18.3	18.3	18.3	18.3
Outlays:									
Discretionary .....	10.1	8.7	6.3	6.6	4.8	4.8	4.8	4.8	4.8
Mandatory:									
Social Security .....	4.3	4.3	4.2	4.2	4.9	5.8	6.0	6.1	6.3
Medicare .....	1.1	1.7	2.0	2.7	3.4	4.5	5.3	5.9	6.1
Medicaid .....	0.5	0.7	1.2	1.4	1.9	2.2	2.5	3.0	3.6
Other .....	3.7	3.2	2.4	2.3	1.8	1.5	1.3	1.0	0.9
Subtotal, mandatory .....	9.6	9.9	9.8	10.6	12.0	14.0	15.1	16.0	16.9
Net Interest .....	1.9	3.2	2.3	1.7	1.0	0.8	1.6	4.1	8.0
Total outlays .....	21.7	21.8	18.4	18.9	17.8	19.7	21.4	24.9	29.7
Surplus or Deficit (-) .....	-2.7	-3.9	2.4	-0.6	0.5	-1.4	-3.1	-6.6	-11.4
Primary Surplus or Deficit (-) .....	-0.8	-0.6	4.7	1.2	1.5	-0.5	-1.6	-2.5	-3.4
Federal Debt Held by the Public .....	26.1	42.0	35.1	35.2	18.7	17.1	31.5	82.0	160.3
Addendum, without the Budget's Mandatory Proposals:									
Mandatory Outlays .....	9.6	9.9	9.8	10.7	12.3	14.6	16.1	17.8	19.6
Surplus or Deficit (-) .....	-2.7	-3.9	2.4	-0.7	0.1	-2.3	-4.9	-10.7	-19.0
Primary Surplus or Deficit (-) .....	-0.8	-0.6	4.7	1.0	1.2	-1.1	-2.6	-4.3	-6.1
Federal Debt Held by the Public .....	26.1	42.0	35.1	35.5	21.1	24.4	47.6	130.3	262.1

Note: The figures shown in this table for 2020 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.

budget projections, see the technical note at the end of this chapter.)

### Alternative Policy, Economic, and Technical Assumptions

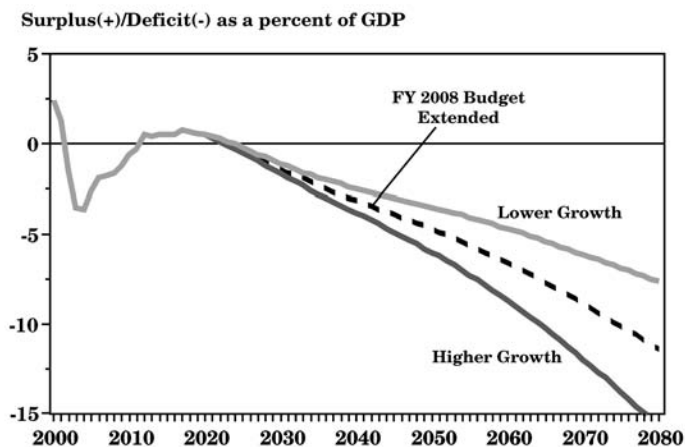
The quantitative results discussed above are sensitive to changes in underlying policy, economic, and technical assumptions. Some of the most important of these alternative assumptions and their effects on the budget outlook are discussed below. They generally show that there are mounting deficits under most reasonable projections of the budget.

1. *Health Spending:* The projections for Medicare over the next 75 years are based on an extension of the Administration's policy proposals to control costs in the Medicare program. These reforms are expected to reduce Medicare expenditures relative to the actuarial projections in the 2006 Medicare Trustees' Report. Following the recommendations of its Technical Review Panel, the Medicare 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 rises faster than GDP throughout the projection period given that the Medicare population is expanding as the population ages, and that Medicare

faces a substantial shortfall in earmarked income compared with projected outgo. Although rising faster than GDP, under these assumptions, Medicare grows less rapidly than it has historically, so that even without reform the program's growth is constrained. The effect of the Administration's proposals is to reduce the imbalance in Medicare by about \$8 trillion over the 75-year forecasting horizon according to actuarial estimates. Instead of facing a \$32 trillion shortfall the program would face a \$24 trillion shortfall, if the Administration's proposals were adopted in full. The proposals would not eliminate the shortfall completely, but they would reduce it substantially.

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, even with the Administration's proposals, is an open question. The alternatives highlight the effect of raising or lowering the projected growth rate in per capita health care costs by  $\frac{1}{4}$  percentage point.

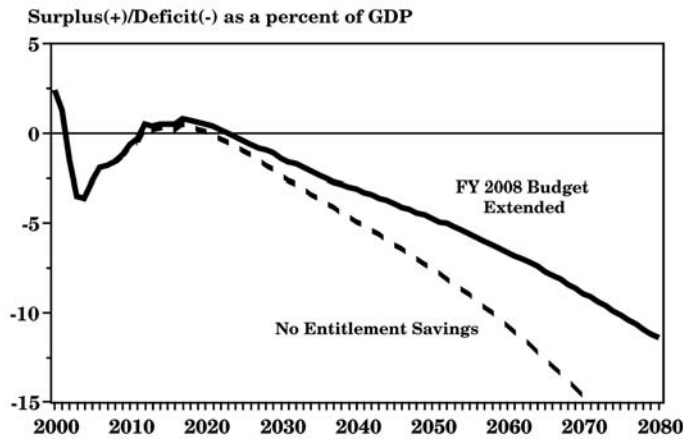
**Chart 13-3. Health Care Cost Alternatives**



2. *Entitlement Savings:* The Administration has proposed a number of savings measures in entitlement programs in addition to the Medicare savings discussed

above. These proposals, if adopted, would have ongoing budgetary effects. The chart shows the long-run deficit with and without these reforms.

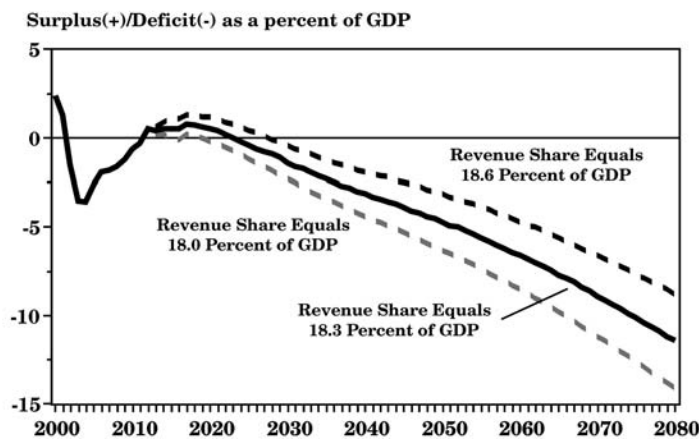
**Chart 13-4. Effect of Entitlement Savings**



3. *Alternative Revenue Shares:* In the base projection, tax receipts are held constant relative to GDP at their average over the last 40 years—18.3 percent of GDP. Tax receipts have risen above this ratio from time to time, most recently at the end of the 1990s, but periods of high taxes have always been followed by tax changes

that have restored the long-term average tax ratio. The chart below shows the effects of alternative receipts assumptions. Allowing receipts to rise to 18.6 percent of GDP would reduce the long-run budget deficit, while holding receipts to 18.0 percent of GDP would have the opposite effect.

**Chart 13-5. Alternative Receipts Projections**



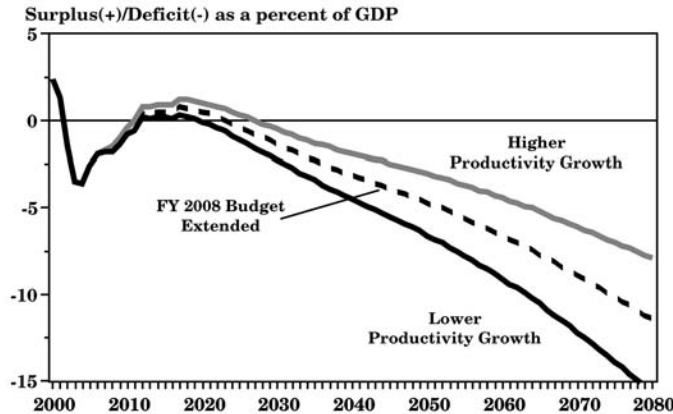
4. *Productivity:* The rate of future productivity growth has a major effect on the long-run budget outlook. It is also highly uncertain. Over the next few decades an increase in productivity growth would reduce projected budget deficits appreciably. Higher productivity growth adds directly to the growth of the major tax bases, while it has a smaller immediate effect on outlay growth even assuming that in the long-run discre-

tionary 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 increased again in the period 2000–2003. The underlying trend of productivity growth has clearly increased since the mid 1990s, and that increase is projected to persist in these long-run projections. This increase in productivity growth is one of the most wel-

come 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; it has grown 2.3 percent per year since 2000, and the projections

here assume that real GDP per hour will continue to grow at a 2.3 percent annual rate. 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**

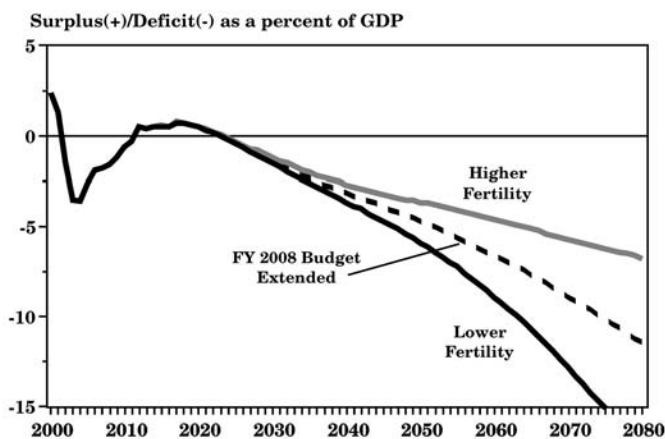


5. *Population:* The key assumptions for projecting long-run demographic developments are fertility, immigration, and mortality.

- The demographic projections assume that fertility will average between 1.9 and 2.0 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**

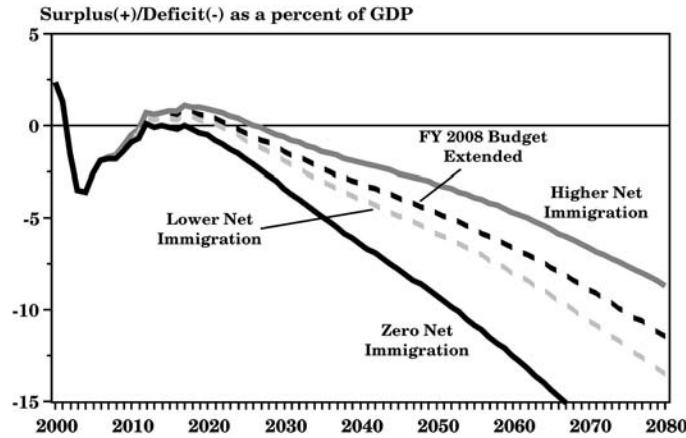


- The rate of immigration is assumed to average around 900,000 per year in these projections. Higher immigration relieves some of the down-

ward 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.

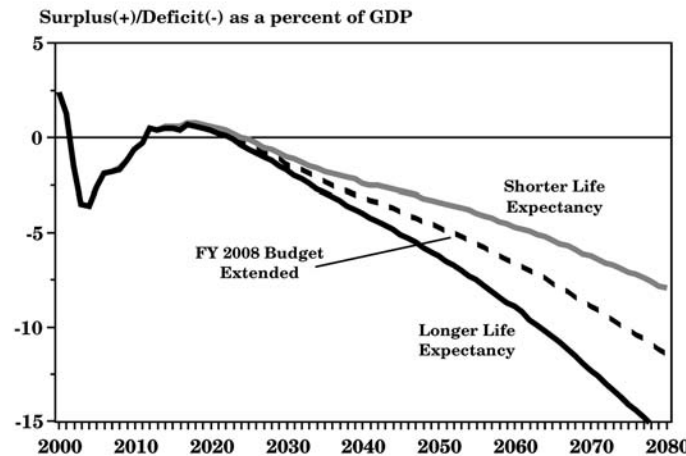
**Chart 13-8. Alternative Immigration Assumptions**



- Mortality is projected to decline, i.e., people are expected to live longer. The average female life-span is projected to rise from 79.6 years in 2004 to 85.1 years by 2080, and the average male life-span is projected to increase from 74.7 years in

2004 to 81.8 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 per-



sistent 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 a huge financial deficiency, and it will be very difficult for the Government as a whole to maintain control of the budget without addressing 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 10 years from now. 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 between future benefits and income is estimated to be \$6.4 trillion over the next 75 years. Extending the horizon to perpetuity increases the imbalance to \$15.3 trillion, excluding trust fund assets as these do not represent a source of funds from a unified budget perspective.

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, people 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 finances health insurance for tens of millions of Americans, including most of the nation's seniors and many individuals with disabilities. It is composed of two programs: Hospital Insurance (HI) or Part A, which covers medical expenses relating to hospitalization and other institutional care, and Supplementary Medical Insurance (SMI) or Part B, which pays for physicians' services and other related expenditures. Starting in 2006, Medicare began to offer a voluntary prescription drug benefit, Medicare Part D, which is funded out 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 2018. Looking at the long run, the Medicare actuaries project a 75-year unfunded promise of Medicare's HI trust fund of around \$11.0 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 over the next 75 years of \$32.3 trillion. Extending the horizon to perpetuity increases the total shortfall to \$70.8 trillion. SMI's financing gap is covered by an unlimited tap on general revenues. According to the Medicare Trustees' 2006 report, "Soon after 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 related and complementary health care services to its beneficiaries. The Medicare Prescription Drug, Improvement, and Modernization Act (MMA), which established Part D, also 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 that highlights the amount of general revenue transfers used to fund Medicare. If the percent of Medicare funding that is from general fund transfers reaches 45 percent within the current or next six years of the projection (2006–2012), the Trustees issue a finding of "excess general revenue Medicare funding". In their 2006 report, the Trustees found that general revenue funding would first reach 45 percent level in fiscal year 2012, within the seven-year window. If a finding is present in two consecutive Trustees' reports, then a "Medicare funding warning" is triggered. This warning requires the President to propose legislation to restore Medicare spending to sustainable levels, but 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 under current-law. 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, but unlike those projections they do not reflect the Administration's proposals to reform the Medicare program and the effects

those proposals would have. More recently, the trustees' reports have also included a projection of the deficiency in perpetuity. This is the clearest way to see the total imbalance in both programs.

The present value of the Social Security imbalance over the next 75 years was estimated to be \$6.4 trillion as of January 1, 2006. The comparable estimate for Medicare was \$32.3 trillion. These estimates exclude the trust fund balances because the balances do not represent a source of funds from a unified budget perspective. (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 2006 trustees' reports. These differ in some respects from the assumptions

used for the long-run budget projections described in the preceding section. Table 13–3 would show a smaller imbalance if the economic assumptions used for the budget had been used for the calculations. In addition, because the estimates are on the basis of current law, they do not reflect the Administration’s proposals to reform Medicare. Under the Administration’s proposals, the Medicare actuaries estimate that the imbalance would be reduced to about \$24 trillion.

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. 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 \$15.3 trillion and for Medicare it is \$70.8 trillion as of January 1, 2006. (Again, the Medicare estimate would be smaller if the effects of the Administration’s policy proposals had been included in the calculation.)

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 2006 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 \$0.3 trillion more than they will collect in benefits. This can be seen by comparing the total deficiency in perpetuity, \$15.3 trillion, with the excess of benefits over taxes for current program participants, \$15.0 trillion, from Table 13–3. In other words, the taxes that future participants are expected to pay will be almost 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 perpetuity shows that the benefits due future participants will eventually exceed projected payroll tax receipts and premiums by a huge margin. The projections into perpetuity shown

at the top of Table 13–3 reveal that total Medicare benefits exceed future taxes and premiums by \$70.8 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 relative to total output in the economy.

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 law. 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 necessarily mean that the Government saved the money recorded there. The trust fund surpluses could have added to national saving if overall government borrowing from 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

Table 13-3. BENEFITS IN EXCESS OF FUTURE TAXES AND PREMIUMS—ACTUARIAL PRESENT VALUES

In Perpetuity as of January 1, in Trillions of Dollars				2004	2005	2006
Social Security .....	.....	.....	.....	11.9	12.8	15.3
Medicare .....	.....	.....	.....	61.9	68.4	70.8
Social Security and Medicare .....	.....	.....	.....	73.8	81.2	86.0
Over a 75-Year Projection Period as of January 1, in Trillions of Dollars		2002	2003	2004	2005	2006
<b>Social Security</b>						
Future benefits less future taxes for those age 62 and over .....	4.1	4.3	4.5	4.9	5.3	
Future benefits less future taxes for those age 15 to 61 .....	7.2	7.4	8.0	8.7	9.6	
Future benefits less taxes for those age 14 and under and those not yet born .....	-6.7	-6.8	-7.3	-7.9	-8.5	
Net present value for present and future participants .....	4.6	4.9	5.2	5.7	6.4	
<b>Medicare</b>						
Future benefits less future taxes for those age 65 and over .....	2.5	2.8	3.8	4.0	4.2	
Future benefits less future taxes for those age 15 to 64 .....	10.4	12.2	20.9	22.4	24.9	
Future benefits less taxes for those age 14 and under and those not yet born .....	0.4	0.8	3.4	3.6	3.3	
Net present value for present and future participants .....	13.3	15.8	28.1	29.9	32.3	
<b>Social Security and Medicare</b>						
Future benefits less future taxes for those who have attained eligibility .....	6.6	7.1	8.3	8.9	9.5	
Future benefits less future taxes for those over age 15 who have not yet attained eligibility .....	17.6	19.7	28.9	31.0	34.5	
Future benefits less taxes for those age 14 and under and those not yet born .....	-6.3	-6.0	-3.9	-4.3	-5.3	
Net present value for present and future participants .....	17.8	20.7	33.3	35.6	38.8	
<b>Addendum:</b>						
Actuarial deficiency as a percent of the discounted payroll tax base:						
Social Security .....	-1.87	-1.92	-1.89	-1.92	-2.02	
Medicare HI .....	-2.02	-2.40	-3.12	-3.09	-3.51	

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, how-

ever, 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 in the long run.

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—TAX COMPLIANCE, NATIONAL WEALTH, AND SOCIAL INDICATORS

To obtain a full picture of the Government's financial condition it is necessary to examine a broad range of

additional information beyond the narrow list of Government-owned assets and liabilities. It is even nec-

essary to consider more information than is contained in the long-term projections of the budget. This final section presents a sample of such additional information. It is intended to provide insight into the full range of resources the Government can draw upon to meet its long-term obligations and also to indicate in a summary way what the Nation obtains in exchange for the resources it provides the Government.

The first piece of additional information is analysis of compliance with the nation's tax laws, the so-called "tax gap." The Government does not collect in a timely manner all of the taxes it is legally owed, as explained in detail below (along with some proposals to narrow the gap). That discussion is followed by an investigation of national wealth and the contributions the Federal Government has made to the wealth of private persons and other levels of government. The final section discusses a range of economic and social indicators which provide information about the outcomes of Government policies.

#### **Improving Tax Fairness and Federal Finances through Better Tax Compliance**

The Internal Revenue Service (IRS) collects over 95 percent of total Federal receipts, \$2.4 trillion in 2006. However, not every dollar of tax legally owed is actually paid. In general, taxpayers comply with the law by filing returns and paying their taxes on time, but some do not comply either because they do not understand their obligations due to the complexity of the tax law or because they seek to avoid those obligations.

*Tax Compliance:* In 2006, the IRS released updated results of its first large study in two decades of the difference between taxes owed and taxes actually paid—the "tax gap." The IRS estimated that taxpayers initially underpaid by \$345 billion in 2001. This equates to a voluntary compliance rate of 84 percent. Late payments and IRS enforcement action reduced this to a net tax gap of \$290 billion, raising the net compliance rate to 86 percent. The Department of the Treasury does not have estimates of the tax gap for the years after 2001. It is possible, however, that lower tax rates,

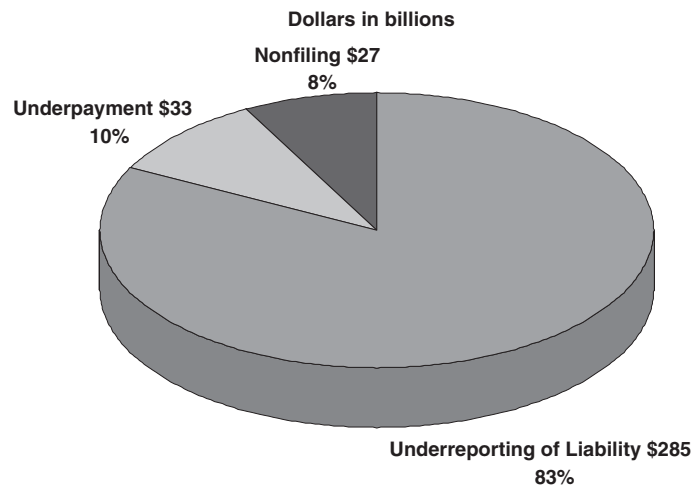
more aggressive enforcement by the IRS, and an improved economic environment have tended to decrease the gap, although inflation and the overall growth of the economy have tended to increase compliance rates over the past six years.

Due to changes in methodologies, comparisons between the 2001 estimates and those from earlier studies should be made cautiously. However, it does appear that the voluntary compliance rate has not changed much since the 1980s. The IRS previously reported voluntary compliance rates of 87 percent in 1988, 86 percent in 1985, and 84 percent in 1983. While the overall rate seems to have moved relatively little over time, each one percentage point change significantly impacts revenue. A one percentage point improvement would increase revenue by \$21 billion per year based on 2001 numbers.

The IRS's compliance estimates, primarily based on random audits of individuals and businesses, are not precise, but give a good general sense of the size of the tax gap and patterns in compliance. This sort of information is critical for effectively targeting IRS enforcement programs to yield the greatest improvement with the smallest cost and burden on taxpayers. The IRS' estimates are most accurate for underpayments of known taxes as recorded in IRS financial systems, and for individual income tax compliance studied through the recent random National Research Program (NRP) study. Non-filing estimates come from studies of census data and are somewhat less precise. The weakest portions of the IRS' estimates are in areas where no recent studies have been completed and the IRS is relying on older data (e.g., for partnerships and corporations).

The gross tax gap results from a variety of honest taxpayer errors and intentional noncompliance. Of the total, 82 percent comes from underreporting of tax liability (see chart). A significant portion of the gap also comes from underpayment of known tax debts and people who fail to file returns. Individual income taxes, the largest source of Federal receipts, account for 71 percent of the tax gap.

**Chart 13-10. Sources of the Gross Tax Gap**



The highest compliance rates come in areas where the IRS has good information about income, because it is reported by third parties (e.g., Form W-2, reporting wage income from employers and Form 1099, reporting various third party payments, including interest from banks). The IRS estimates that 95 percent of income with third-party reporting but no withholding (e.g., interest income, dividends) is declared on taxpayer returns. Where there is tax withholding, as in the case of most wages, nearly 99 percent of the amounts reported by payers is declared on taxpayer returns.

Conversely, error rates are high for income with little or no third-party reporting. For example, an estimated 43 percent of the tax gap comes from business income that should be reported on individual returns (Forms 1040) but goes unreported to the IRS (see chart).

*Improving Tax Compliance:* While the tax gap can never be entirely eliminated, reducing the gap by improving compliance is important because non-compliant taxpayers impose unacceptable burdens on other taxpayers and on Federal finances.

**Table 13-4. SOURCES OF THE TAX GAP FROM INCOME UNDERREPORTING**

	Contribution to the Tax Gap in Dollars	Percent Share of the Overall Tax Gap
Business income underreported by individuals including small business owners .....	148	43
Non-business income underreporting and improper deductions and credits .....	88	26
Corporate income underreporting .....	30	9
Other underreporting .....	19	6
Total Underreporting .....	285	84

The challenge is to find ways to improve compliance without unduly burdening compliant taxpayers or the economy. For example, as noted above, income reported to the IRS by third parties is claimed on tax returns at a far higher rate than other income. Requiring third-party reporting of all income would likely raise compliance levels. However, this is not possible in all cases and even where it is possible it might require burdensome new reporting requirements for individuals and businesses. For example, individuals paying a contractor or purchasing a car might be required to file reports to the IRS reporting these transactions. Such broad expansions of reporting requirements would be excessively burdensome, and that this consideration outweighs the gains they might bring in increased compliance.

Similarly, requiring much more detailed documentation, such as evidence supporting claims for deductions and credits or providing accounting records supporting business income claims, would quite possibly improve compliance. In some cases more detailed documentation may be appropriate. However, unless carefully targeted, this is likely to impose an unacceptable increase in cost on both taxpayers and the IRS and to decrease privacy.

Another approach to improving compliance would be to change the tax code to remove tax benefits wherever there is the potential for abuse. For example, deductions for non-cash giving could be prohibited. This would prevent the overstatement of charitable deductions by some taxpayers. However, it would also impose a tax increase on the millions of taxpayers who currently take legitimate deductions for non-cash giving. Compliant taxpayers are likely to regard this approach as overly broad. Finally, much higher audit rates might improve compliance, but would be extremely expensive

and unless properly targeted could be unduly burdensome to honest taxpayers.

The Administration has developed a carefully targeted plan for reducing the tax gap, which is described in the Department of the Treasury's "A Comprehensive Strategy for Reducing the Tax Gap" (see [www.ustreas.gov/press/releases/hp111.htm](http://www.ustreas.gov/press/releases/hp111.htm)). This document lays out a multi-year, seven-part strategy to improve compliance without imposing undue burdens on taxpayers. The Budget provides a \$410 million initiative in the IRS to begin implementing this strategy. Components of the strategy include:

*Reduce Opportunities for Evasion:* The Administration will pursue carefully targeted tax law changes to promote compliance while causing minimal taxpayer burden and IRS cost increases. The Budget includes 16 legislative proposals, such as expanding third party information reporting where it can be done with acceptable levels of taxpayer burden (e.g., including payments to corporations in existing third-party reporting requirements and requiring brokers to report the cost basis for certain securities' sales). (See chapter 17, "Federal Receipts" for a full description of these legislative proposals.)

*Multi-Year Commitment to Research:* Improved research on tax gap causes and potential remedies will help the IRS target its enforcement and service programs to achieve the greatest possible impact at the lowest cost.

*Investments in Information Technology:* Modernized computer systems will give IRS staff the tools they need to improve efficiency, service and compliance.

*Improve Compliance Activities:* Through re-engineering and selected funding increases the IRS will improve the effectiveness of its enforcement efforts to increase the fairness of the tax system by ensuring that everyone pays their share.

*Taxpayer Service:* Improved service will help taxpayers avoid unintentional errors and will make filing easier. Improved telephone service, new internet tools, and increases in electronic filing have already helped taxpayers file more accurate returns with less effort.

*Reform and Simplify the Tax Law:* Simplifying the tax law will reduce unintentional errors caused by a lack of understanding. Simplification will also reduce the opportunities for intentional evasion and make it easier for the IRS to administer the tax laws.

*Coordinate with Partners and Stakeholders:* Closer coordination is needed between the IRS and state and foreign governments to share information and compliance strategies. Closer coordination is also needed with practitioner organizations, including bar and accounting associations, to maintain and improve mechanisms to ensure that advisors provide appropriate tax advice.

Collectively these efforts will reduce the tax gap and improve the fiscal situation of the Government. Equally important, better compliance will improve the fairness of the tax system. Implementation depends on effective IRS leadership, to improve factors such as technology investments and reengineering processes, as well as the

active support of the Congress to implement tax law changes and provide funding for these improvements.

### **The Federal Contribution to National Wealth**

The Government relies on private wealth to support its activities. It also contributes to that wealth. 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, 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, these investments augment future tax receipts. The return on investment that comes back to the Government in the form of higher taxes, however, is far less than what a private investor would require before undertaking a similar investment.

The Federal Government also supports education and research and development (R&D). These outlays contribute to future productivity and are analogous to investments 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 balance sheet.

To show the importance of these kinds of issues, Table 13-5 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 13-5 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: \$7.8 trillion. The Federal contribution is down from 9 percent in the early 1980s and from 12 percent in 1960. Much of this decline reflects the relative shrinkage in the stock of defense capital, which has fallen from around 34 percent of GDP in 1960 to under 6 percent in 2006.

*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, \$60.5 trillion in 2006, consisting of \$50.8 trillion in private physical capital and \$9.7 trillion in public physical capital (including capital funded by

**Table 13–5. NATIONAL WEALTH**  
(As of the end of the fiscal year, in trillions of 2006 dollars)

	1960	1965	1970	1975	1980	1985	1990	1995	2000	2004	2005	2006
<b>ASSETS</b>												
Publicly Owned Physical Assets:												
Structures and Equipment .....	2.3	2.6	3.2	3.9	4.2	4.4	4.8	5.3	6.0	6.9	7.4	7.6
Federally Owned or Financed .....	1.3	1.4	1.5	1.7	1.8	2.0	2.2	2.3	2.3	2.4	2.5	2.6
Federally Owned .....	1.2	1.1	1.2	1.2	1.1	1.2	1.3	1.3	1.1	1.1	1.1	1.2
Grants to State and Local Governments .....	0.2	0.2	0.4	0.6	0.7	0.8	0.9	1.0	1.2	1.3	1.4	1.4
Funded by State and Local Governments .....	1.0	1.2	1.6	2.2	2.4	2.4	2.6	3.0	3.7	4.5	4.9	5.0
Other Federal Assets .....	0.8	0.8	0.7	0.9	1.4	1.5	1.2	0.9	1.3	1.8	2.1	2.2
Subtotal .....	3.1	3.3	3.9	4.8	5.6	5.9	6.0	6.2	7.3	8.7	9.5	9.7
Privately Owned Physical Assets:												
Reproducible Assets .....	7.7	8.8	10.8	13.9	18.1	19.2	21.9	24.2	29.4	33.8	35.3	35.5
Residential Structures .....	3.0	3.5	4.2	5.3	7.3	7.5	8.6	9.8	12.2	15.2	16.0	16.1
Nonresidential Plant & Equipment .....	3.0	3.4	4.3	5.7	7.4	8.1	9.1	9.9	12.0	13.1	13.7	13.6
Inventories .....	0.8	0.8	1.0	1.3	1.6	1.4	1.5	1.6	1.8	1.8	1.8	1.9
Consumer Durables .....	0.9	1.1	1.3	1.6	1.9	2.1	2.7	3.0	3.4	3.7	3.8	3.9
Land .....	2.3	2.7	3.1	4.1	6.3	7.1	7.3	5.5	8.5	11.7	14.0	15.3
Subtotal .....	10.0	11.6	14.0	18.0	24.3	26.3	29.2	29.7	37.9	45.4	49.3	50.8
Education Capital:												
Federally Financed .....	0.1	0.1	0.3	0.4	0.5	0.7	0.8	1.0	1.3	1.5	1.6	1.7
Financed from Other Sources .....	6.4	8.6	11.5	14.6	18.7	21.8	27.1	31.8	40.6	45.8	46.9	48.4
Subtotal .....	6.4	8.7	11.8	15.0	19.2	22.5	27.9	32.9	41.9	47.3	48.5	50.0
Research and Development Capital:												
Federally Financed R&D .....	0.2	0.4	0.5	0.6	0.7	0.8	0.9	1.0	1.1	1.2	1.3	1.3
R&D Financed from Other Sources .....	0.1	0.2	0.3	0.4	0.5	0.7	1.0	1.2	1.7	2.0	2.1	2.1
Subtotal .....	0.3	0.6	0.9	1.0	1.2	1.5	1.9	2.3	2.8	3.2	3.3	3.5
<b>Total Assets</b> .....	19.8	24.2	30.5	38.9	50.3	56.2	65.1	71.0	89.9	104.7	110.6	114.0
Net Claims of Foreigners on U.S. ....	-0.1	-0.2	-0.2	-0.1	-0.4	0.1	0.9	1.6	3.2	4.7	5.8	6.1
<b>Net Wealth</b> .....	19.9	24.4	30.7	39.0	50.7	56.1	64.2	69.4	86.7	99.9	104.9	108.0
<b>ADDENDA:</b>												
Per Capita Wealth (thousands of 2006 \$) .....	110.5	125.7	150.0	180.7	222.4	235.1	256.2	259.9	306.7	339.5	353.0	360.3
Ratio of Wealth to GDP (in percent) .....	682.9	665.2	700.3	784.4	853.2	790.8	773.8	740.2	757.3	798.3	810.5	810.2
Total Federally Funded Capital (trils 2006 \$) .....	2.4	2.6	3.1	3.6	4.4	5.0	5.2	5.3	6.0	7.0	7.5	7.8
Percent of National Wealth .....	11.9	10.8	10.0	9.3	8.7	8.9	8.1	7.6	7.0	7.0	7.2	7.2

State and local governments); by comparison, GDP was around \$13 trillion in 2006. The Federal Government's contribution to this stock of capital includes its own physical assets of \$3.3 trillion plus \$1.4 trillion in accumulated grants to State and local governments for capital projects. The Federal Government has financed over 20 percent 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 13–5 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 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 \$50 trillion in 2006, 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 train-



ing, 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.<sup>5</sup> That stock is estimated to have been \$3.5 trillion in 2006. 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. Table 13–5 only shows National totals. Gross debt is important even though it does not appear in Table 13–5. 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 13–5 are the debts Americans owe to foreigners for the investments that foreigners have made in the United States. 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. In 2006, it amounted to 5 percent of total assets including education and R&D capital.

Federal debt does not appear explicitly in Table 13–5 because much 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 mag-

nitude of the imbalance in the Government's accounts. Federal net liabilities, as reported in Table 13–1, amounted to 5.7 percent of net U.S. wealth as shown in Table 13–5. 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 2006 was \$108 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 4.1 percent since 1995. 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 2006. It grew especially rapidly from 1960 to 1973, at an average rate of 4.1 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. Privately owned residential structures and land have all grown much more rapidly in real value since 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. It grew at an average rate of 5.9 percent per year in the 1960s, 2.0 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 3.9 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. R&D

<sup>5</sup>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.

**Table 13–6. TRENDS IN NATIONAL WEALTH**

(Average Annual Rates in Percent)

	1960–06	1960–1973	1973–1995	1995–2006
Real GDP .....	3.4	4.3	2.8	3.3
National Wealth .....	3.7	4.5	3.1	4.1
Private Physical Wealth .....	3.6	3.9	2.7	5.0
Nonresidential Plant and Equipment .....	3.3	4.1	3.1	2.9
Residential Structures .....	3.7	4.0	3.1	4.6
Consumer Durables .....	3.1	3.6	3.2	2.5
Public Physical Wealth .....	2.6	2.8	1.6	4.2
Net Education .....	4.6	5.9	4.1	3.9
Net R&D .....	5.2	8.6	3.9	3.9

TABLE 13-7. ECONOMIC AND SOCIAL INDICATORS

Calendar Years	1960	1970	1980	1990	1995	2000	2004	2005	2006
<b>Economic:</b>									
Living Standards:									
Real GDP per person (2000 dollars) (a) .....	13,840	18,392	22,666	28,429	30,128	34,759	36,415	37,241	38,136
average annual percent change (5-year trend) .....	0.6	2.3	2.6	2.3	1.2	2.9	1.4	1.4	1.9
Real Disposable Personal Income Per Capita .....	9,735	13,563	16,940	21,281	22,153	25,472	27,254	27,318	27,761
average annual percent change (5-year trend) .....	1.2	3.2	2.1	1.8	0.8	2.8	2.1	1.4	1.6
Median Income: All Households (2005 dollars) .....	N/A	38,026	39,739	43,366	43,346	47,599	45,817	46,326	N/A
average annual percent change (5-year trend) .....	N/A	N/A	1.0	1.2	0.0	1.9	-0.8	-0.5	N/A
Income Share of Lower 60% of All Households .....	31.8	32.3	31.2	29.3	28.0	27.3	26.8	26.6	N/A
Poverty Rate (%) (b) .....	22.2	12.6	13.0	13.5	13.8	11.3	12.7	12.6	N/A
Economic Security:									
Civilian Unemployment (%) .....	5.5	4.9	7.1	5.5	5.6	4.0	5.5	5.1	4.6
CPI-U (% Change) .....	1.7	5.7	13.5	5.4	2.8	3.4	2.7	3.4	3.2
Payroll Employment Increase (millions) (c) .....	-0.4	-0.4	0.3	0.3	2.2	1.9	2.1	2.6	2.0
Managerial or Professional Jobs (% of civilian employment) ...	N/A	N/A	N/A	29.2	32.0	33.8	34.9	34.7	34.9
Wealth Creation:									
Net National Saving Rate (% of GDP) (d) .....	10.6	8.3	7.4	4.4	4.1	5.9	0.9	0.1	2.0
Innovation:									
Patents Issued to U.S. Residents (thousands) (e) .....	42.3	50.6	41.7	56.1	64.5	97.0	94.1	82.6	N/A
Multifactor Productivity (average 5 year percent change) .....	0.8	0.8	0.8	0.6	0.6	1.2	1.7	N/A	N/A
Nonfarm Output per Hour (average 5 year percent change) ...	1.8	2.1	1.1	1.6	1.5	2.5	3.2	3.1	3.0
<b>Environment:</b>									
Air Quality:									
Nitrogen Oxide Emissions (millions of tons) .....	18	27	27	26	25	23	20	19	N/A
Sulfur Dioxide Emissions (millions of tons) .....	22	31	26	23	19	16	15	15	N/A
Carbon Monoxide (millions of tons) .....	N/A	197	178	144	120	102	N/A	89	N/A
Lead Emissions (thousands of tons) .....	N/A	221	74	5	4	3	3	3	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
<b>Social:</b>									
Families:									
Children Living with Mother Only (% of all children) .....	9.2	11.6	18.6	21.6	24.0	22.3	23.7	23.4	N/A
Safe Communities:									
Violent Crime Rate (per 100,000 population) (f) .....	160.0	364.0	597.0	729.6	684.5	506.5	463.2	469.2	482.2
Murder Rate (per 100,000 population) (g) .....	5.1	7.8	10.2	9.4	8.2	5.5	5.5	5.6	5.6
Murders (per 100,000 Persons Age 14 to 17) .....	N/A	N/A	5.9	9.8	11.0	4.8	4.6	N/A	N/A
Health:									
Infant Mortality (per 1000 Live Births) (g) .....	26.0	20.0	12.6	9.2	7.6	6.9	6.8	6.8	6.7
Low Birthweight [<2,500 gms] Babies (%) (g) .....	7.7	7.9	6.8	7.0	7.3	7.6	8.1	8.2	N/A
Life Expectancy at birth (years) .....	69.7	70.8	73.7	75.4	75.8	77.0	77.9	N/A	N/A
Cigarette Smokers (% population 18 and older) .....	N/A	39.2	33.0	25.3	24.6	23.1	20.8	20.9	N/A
Overweight (% population 20-74 with Body-Mass Index)2.5)	44.5	47.5	47.2	54.6	60.7	65.0	66.2	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	85.2	85.2	N/A
College Graduates (% of population 25 and older) .....	8.4	11.0	17.0	21.3	23.0	25.6	27.7	27.6	N/A
National Assessment of Educational Progress (h)									
Reading 17-year olds .....	N/A	N/A	285.0	290.0	288.0	287.4	285.0	N/A	N/A
Mathematics 17-year olds .....	N/A	N/A	299.0	305.0	306.5	307.8	307.0	N/A	N/A
Participation:									
Individual Charitable Giving per Capita (2000 dollars) .....	281	381	373	465	449	692	639	N/A	N/A
(by election year) .....	(1960)	(1972)	(1980)	(1984)	(1988)	(1992)	(1996)	(2000)	(2004)
Voting for President (% eligible population) .....	62.8	55.1	52.8	53.3	50.3	55.2	49.0	50.3	55.5

(a) Forecast data are used for the fourth quarter of 2006.

(b) The poverty rate does not reflect noncash government transfers such as Medicaid or food stamps.

(c) The data for 2005-2006 reflect the expected 810,000 benchmark revision scheduled for February 2007.

(d) 2006 through Q3 only.

(e) Preliminary data for 2005.

(f) Not all crimes are reported, and the fraction that go unreported may have varied over time, preliminary data for 2006.

(g) Provisional data for 2005-2006; data for 2006 through April.

(h) Data for some years are interpolated.

stocks have also grown at an average rate of 3.9 percent per year since 1995.

### Other Federal Influences on Economic Growth

Federal investment decisions, as reflected in Table 13-5, 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 credit and insurance policies.

### 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 13-7 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 13-7 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.

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.

Some of the trends in these indicators turned around in the 1990s. The improvement in economic conditions beginning around 1995 has been widely noted, and there have also been some social improvements. Perhaps, most notable has been the turnaround in the crime rate. After reaching a peak in the early 1990s, violent crime fell 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, although the last two years have seen an uptick in murders. The 2001 recession had a negative effect on some of these indicators: unemployment rose and real GDP growth declined, but as the economy recovered much of the improvement shown in Table 13-7 was preserved. Indeed, productivity growth, the best indicator of future changes in the standard of living, accelerated and has grown at a faster average rate since 2001 than at any comparable 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 2007-2017, 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 2006 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 2.3 percent per year; the unemployment rate is constant at 4.8 percent; and the yield on 10-year Treasury notes is steady at 5.3 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 0.3 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 2.6 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 2012, receipts follow the budget's policy projections. After 2012, receipts are assumed to return gradually to their share of GDP over the last 40 years, 18.3 percent, and to remain at that lower share over the long run. Discretionary spending follows the growth policies in the Budget over the next ten years and grows at the rate of growth in nominal GDP afterwards. Other spending also aligns with the Budget through the budget horizon, except that the Social Security program does not include the proposal to incorporate personal accounts in the program. Long-run Social Security spending is projected by the Social Security actuaries using this Chapter's long-range assumptions. Medicare benefits are projected based on the estimates in the 2006 Medicare trustees' report, adjusted for differences in the assumed inflation rate and the growth rate in real GDP per capita, and further adjusted for the estimated long-run effects of the Administration's policy proposals. 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 De-

partment 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.

*Environmental Liabilities:* The source of data for environmental liabilities was the *Financial Report of the United States Government* for 2006 and previous years. Prior to 1994, the estimates were extrapolated assuming a constant ratio to GDP.

### 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 2006.

*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 2006 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 per-

cent 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.<sup>1</sup> 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.<sup>2</sup> 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

<sup>1</sup>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.

<sup>2</sup>Over the period 1994–2006, NIPA current expenditures averaged 3.8 percent higher than budget outlays, while NIPA current receipts averaged 2.4 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. 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.

Certain items in the budget are excluded from the NIPA Federal current account because they are capital transfers that are related to the acquisition or sale of assets, and not related to current consumption or income. 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.

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, 1997–2008**

(In billions of dollars)

Description	Actual										Estimate	
	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
<b>CURRENT RECEIPTS</b>												
Current tax receipts .....	1010.2	1105.9	1165.2	1305.6	1266.9	1089.7	1065.9	1118.9	1323.9	1527.2	1639.9	1708.9
Personal current taxes .....	729.0	814.1	868.5	987.4	993.8	851.1	781.7	787.2	909.0	1028.6	1151.6	1231.6
Taxes on production and imports .....	77.2	80.7	82.5	87.8	86.4	86.4	89.1	93.1	99.7	106.0	102.5	108.1
Taxes on corporate income .....	198.9	205.9	207.9	223.5	179.5	144.7	186.8	229.4	304.3	381.6	374.5	357.8
Taxes from the rest of the world .....	5.1	5.2	6.2	6.8	7.1	7.4	8.3	9.2	11.0	11.0	11.3	11.3
Contributions for government social insurance .....	565.5	604.4	642.2	687.8	713.8	729.6	749.9	788.0	849.9	890.1	944.6	995.6
Income receipts on assets .....	26.7	22.3	20.9	24.3	26.4	21.3	21.4	22.4	23.7	24.8	25.0	26.2
Current transfer receipts .....	23.8	21.0	21.8	24.9	26.5	25.5	24.7	26.9	6.4	35.1	33.3	38.2
Current surplus of government enterprises .....	0.2	0.0	0.3	-1.3	-6.5	-1.1	2.5	0.2	-5.3	-3.6	-2.0	-1.6
<b>Total current receipts .....</b>	<b>1626.4</b>	<b>1753.5</b>	<b>1850.3</b>	<b>2041.2</b>	<b>2027.1</b>	<b>1865.0</b>	<b>1864.4</b>	<b>1956.4</b>	<b>2198.6</b>	<b>2473.6</b>	<b>2640.9</b>	<b>2767.4</b>
<b>CURRENT EXPENDITURES</b>												
Consumption expenditures .....	454.6	452.9	469.5	496.0	519.7	575.5	648.0	707.2	758.0	803.3	865.7	906.9
Defense .....	304.4	301.3	307.2	321.2	335.7	368.4	424.5	470.9	508.8	532.8	579.1	617.2
Nondefense .....	150.2	151.6	162.3	174.8	184.0	207.1	223.5	236.3	249.2	270.5	286.6	289.7
Current transfer payments .....	908.2	940.3	976.4	1023.2	1108.0	1216.6	1308.9	1379.6	1462.5	1543.1	1655.1	1721.1
Government social benefits .....	700.0	716.4	733.0	762.7	823.6	900.9	956.3	1007.4	1072.0	1151.4	1244.9	1306.1
Grants-in-aid to State and local governments ..	194.1	209.9	227.7	244.1	268.2	296.7	329.3	347.6	359.5	361.4	373.9	377.2
Other transfers to the rest of the world .....	14.2	14.0	15.7	16.4	16.3	19.0	23.2	24.5	31.0	30.4	36.4	37.8
Interest payments .....	299.4	299.7	285.9	283.3	267.9	234.9	214.6	216.6	242.3	286.7	306.2	331.9
Subsidies .....	31.3	33.6	36.1	49.6	53.7	37.9	46.1	43.5	53.6	54.4	47.3	46.3
Wage disbursements less accruals .....												
<b>Total current expenditures .....</b>	<b>1693.5</b>	<b>1726.5</b>	<b>1767.9</b>	<b>1852.0</b>	<b>1949.3</b>	<b>2064.9</b>	<b>2217.6</b>	<b>2346.9</b>	<b>2516.3</b>	<b>2687.5</b>	<b>2874.3</b>	<b>3006.2</b>
<b>Net Federal Government saving .....</b>	<b>-67.1</b>	<b>27.0</b>	<b>82.4</b>	<b>189.2</b>	<b>77.8</b>	<b>-199.9</b>	<b>-353.2</b>	<b>-390.5</b>	<b>-317.7</b>	<b>-213.9</b>	<b>-233.4</b>	<b>-238.9</b>
<b>ADDENDUM: TOTAL RECEIPTS AND EXPENDITURES</b>												
Current receipts .....	1626.4	1753.5	1850.3	2041.2	2027.1	1865.0	1864.4	1956.4	2198.6	2473.6	2640.9	2767.4
Capital transfer receipts .....	19.7	23.9	27.6	28.8	28.2	26.4	21.7	24.7	24.5	27.7	25.0	25.5
<b>Total receipts .....</b>	<b>1646.1</b>	<b>1777.4</b>	<b>1877.9</b>	<b>2070.1</b>	<b>2055.3</b>	<b>1891.3</b>	<b>1886.1</b>	<b>1981.1</b>	<b>2223.1</b>	<b>2501.3</b>	<b>2666.0</b>	<b>2792.8</b>
Current expenditures .....	1693.5	1726.5	1767.9	1852.0	1949.3	2064.9	2217.6	2346.9	2516.3	2687.5	2874.3	3006.2
Net investment:												
Gross government investment:												
Defense .....	44.5	45.4	46.5	48.5	49.9	54.5	59.0	65.0	71.7	76.9	86.7	79.1
Nondefense .....	28.5	29.7	31.9	32.2	30.3	32.6	33.3	33.4	36.0	37.0	38.0	40.0
Less: Consumption of fixed capital:												
Defense .....	60.6	59.8	59.7	60.2	60.3	60.4	61.4	63.4	67.2	70.8	74.2	77.2
Nondefense .....	21.8	22.9	24.5	26.5	27.7	28.2	28.7	29.3	30.7	32.5	32.4	33.5
Capital transfer payments .....	29.0	28.2	31.3	39.3	39.8	44.3	62.0	62.9	66.0	69.4	77.8	77.4
Net purchases of nonproduced assets .....	-11.0	-5.3	-1.7	-0.3	-0.9	0.3	0.1	0.1	-0.9	0.0	-13.7	-13.3
<b>Total expenditures .....</b>	<b>1702.3</b>	<b>1741.8</b>	<b>1791.8</b>	<b>1885.1</b>	<b>1980.3</b>	<b>2108.0</b>	<b>2281.9</b>	<b>2415.6</b>	<b>2591.2</b>	<b>2767.6</b>	<b>2956.5</b>	<b>3079.0</b>
<b>Net lending or net borrowing (-) .....</b>	<b>-56.2</b>	<b>35.7</b>	<b>86.1</b>	<b>185.0</b>	<b>75.0</b>	<b>-216.7</b>	<b>-395.8</b>	<b>-434.5</b>	<b>-368.1</b>	<b>-266.2</b>	<b>-290.6</b>	<b>-286.1</b>

\$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 cor-

porate 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 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 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	
	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
<b>RECEIPTS</b>												
Budget receipts .....	1579.4	1722.0	1827.6	2025.5	1991.4	1853.4	1782.5	1880.3	2153.9	2407.3	2540.1	2662.5
Contributions to government employee retirement plans .....	-4.4	-4.3	-4.5	-4.8	-4.7	-4.6	-4.6	-4.6	-4.5	-4.4	-4.7	-4.7
Capital transfers received .....	-19.7	-23.9	-27.6	-28.8	-28.2	-26.3	-21.7	-24.7	-24.5	-27.7	-25.0	-25.5
Other coverage differences .....	-3.9	-5.8	-7.0	-8.0	-7.9	-8.9	-9.0	-10.1	-11.0	-12.2	-12.4	-13.1
Netting and grossing .....	69.5	64.5	65.7	70.6	69.9	77.0	85.1	88.4	70.7	112.7	121.7	133.7
Timing differences .....	5.5	1.1	-3.9	-13.2	6.7	-25.6	32.1	27.1	14.0	-2.0	21.2	14.4
<b>NIPA current receipts</b> .....	1626.4	1753.5	1850.3	2041.2	2027.1	1865.0	1864.4	1956.4	2198.6	2473.6	2640.9	2767.4
<b>EXPENDITURES</b>												
Budget outlays .....	1601.3	1652.7	1702.0	1789.2	1863.2	2011.2	2160.1	2293.0	2472.2	2655.4	2784.3	2901.9
Government employee retirement plan transactions .....	31.6	31.3	32.1	31.7	31.5	33.7	33.1	33.5	39.4	42.4	44.4	47.4
Deposit insurance and other financial transactions .....	-6.4	-7.1	-6.1	-9.0	-6.2	-6.7	2.1	-0.8	-0.8	-9.1	-19.2	-25.2
Capital transfer payments .....	-28.9	-28.2	-31.3	-35.1	-39.8	-44.1	-45.4	-46.4	-47.7	-51.2	-53.9	-55.8
Net purchases of nonproduced assets .....	11.0	5.3	1.7	0.3	0.9	-0.3	-0.1	-0.1	0.7	0.0	13.7	13.3
Net investment .....	9.3	7.6	5.7	6.0	7.9	1.4	-2.3	-5.7	-9.8	-10.6	-18.1	-8.5
Other coverage differences .....	11.4	1.0	2.7	4.0	7.9	-0.6	-13.5	-20.2	-25.1	-38.1	-7.5	-1.1
Netting and grossing differences .....	69.5	64.5	65.7	70.6	69.9	77.0	85.1	88.4	70.7	112.7	121.7	133.7
Timing differences .....	-5.4	-0.7	-4.7	-5.6	14.3	-6.7	-1.6	5.1	16.6	-14.0	8.9	0.7
<b>NIPA current expenditures</b> .....	1693.5	1726.5	1767.8	1852.0	1949.3	2064.9	2217.6	2346.9	2516.3	2687.5	2874.3	3006.2
<b>ADDENDUM</b>												
Budget surplus or deficit (-) .....	-21.9	69.3	125.6	236.2	128.2	-157.8	-377.6	-412.7	-318.3	-248.2	-244.2	-239.4
NIPA net Federal Government saving .....	-67.1	27.0	82.4	189.2	77.8	-199.9	-353.2	-390.5	-317.7	-213.9	-233.4	-238.9

\* \$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 2003–2008, however, the NIPA net Federal Government saving was, or is estimated to be, a smaller negative number than the budget deficit.

Table 14-1 displays Federal transactions using NIPA concepts with actual data for 1997–2006 and estimates for 2007 and 2008 consistent with the Administration's budget proposals. Table 14-2 summarizes the reasons for differences between the data. Annual NIPA data for 1948–2008 are published in Section 14 of a separate budget volume, *Historical Tables, Budget of the U.S. Government, Fiscal Year 2008*.

Detailed estimates of NIPA current receipts and expenditures consistent with the budget and including quarterly estimates 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 [www.bea.doc.gov/beatpubs.htm](http://www.bea.doc.gov/beatpubs.htm).



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## BUDGET REFORM PROPOSALS

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## 15. BUDGET REFORM PROPOSALS

The budget process should be transparent, accountable, and orderly. The current budget process needs reforms to 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, as well as an extension with changes to key provisions of the Budget Enforcement Act (BEA) of 1990, as amended, that are designed to improve budget decisions and outcomes. This chapter updates the Administration's previous 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. This proposal effectively applies a pay-as-you-go requirement to mandatory spending. Table 15–1 displays the President's mandatory spending proposals that would be subject to this requirement.

*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 program's 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. If a warning was issued and action was not taken over the next six years to keep this threshold from being 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.

Social Security's Disability Insurance (DI) program provides disability insurance coverage and benefits to

**Table 15–1. MANDATORY PROPOSALS SUBJECT TO PAYGO**

(Cost/Savings (–) in millions of dollars)

Proposals	2007	2008	2009	2010	2011	2012	2007–12
Medicare .....		–4,696	–9,113	–13,077	–17,463	–21,695	–66,044
Outlay Effects of Tax Proposals <sup>1</sup> .....		–388	–297	4,021	4,100	4,086	11,522
Medicaid/State Children's Health Insurance Program .....	35	–330	–870	–1,765	–1,790	–2,005	–6,725
User Fee Proposals .....		–774	–1,021	–1,178	–1,187	–1,315	–5,476
Pension Benefit Guaranty Corporation Reform .....			–1,390	–1,387	–1,400	–1,295	–5,472
ANWR Leasing .....			–3,502	–2	–503	–3	–4,010
Federal Student Aid Proposals .....		–3,652	–356	–69	365	769	–2,943
Farm Bill Reauthorization .....		500	500	500	500	500	2,500
Social Services Block Grant .....			–425	–495	–500	–500	–1,920
Unemployment Insurance Integrity Proposal <sup>1</sup> .....			–484	–494	–351	–355	–1,684
Other Proposals .....	–125	–1,215	–602	–687	–715	–895	–4,238
<b>Total .....</b>	<b>–90</b>	<b>–10,555</b>	<b>–17,560</b>	<b>–14,633</b>	<b>–18,944</b>	<b>–22,708</b>	<b>–84,490</b>
<b>Total, 2007 and 2008 .....</b>		<b>–10,645</b>					

<sup>1</sup> Affects both receipts and outlays. Only the outlay effect is shown here. For receipt effects, see Table S–6 in the *Budget* volume.

Note: a more detailed list of the Administration's mandatory proposals can be found in Table S–5 of the *Budget* volume.

America's workers. Outlays for the DI program have grown as a percentage of all Federal budget outlays from roughly 2.1 percent in 1989 to an estimated 3.6 percent in 2007. The Budget projects DI outlays will continue to increase as a percentage of the Federal budget, along with escalating annual cash deficits. The President's Budget proposes a new Funding Warning to highlight the escalating and persistent fiscal problems facing DI. If SSA's actuaries project a negative DI cash flow that is more than 10 percent of program cost for four consecutive years in the upcoming 10 years, the Board of Trustees will issue the warning in the annual Trustees Report. Issuance of a DI Funding Warning would require the President to propose legislation to respond to the warning within 15 days after the date of the next Budget submission; the Congress would then consider this legislation. The analysis of DI's budgetary impact will safeguard an important source of disability insurance while promoting sound fiscal policy.

In addition to this Medicare-specific control mechanism and DI Funding Warning, the President's Budget proposes to establish a broader enforcement measure to analyze the long-term 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 that 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. Under these requirements, the Administration would 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. This effectively establishes a pay-as-you-go requirement for discretionary administrative actions involving mandatory spending programs. Exceptions to this requirement are only provided in extraordinary or compelling circumstances.

### Controlling Discretionary Spending

*Discretionary Caps.*—The Administration proposes to set limits for 2007 through 2012 on net discretionary budget authority and outlays equal to the levels proposed in the 2008 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 2007 through 2012. This approach would put in place a budget framework for the next five years that ensures constrained, but reasonable growth in discretionary programs. For 2007 through 2009, separate defense (Function 050) and nondefense categories would be enforced. For 2010–2012, there would be a single cap for all discretionary spending.

These discretionary levels do not reflect the Administration's proposal to replace aviation taxes that are currently recorded as governmental receipts with FAA user fees that would be recorded as offsetting collections. This budget-neutral reclassification lowers receipts and net budget authority by an identical amount and does not affect gross discretionary budget authority levels. If this proposal is enacted, the Administration would adjust discretionary spending levels downward for FY 2009–2012 by the amount of the proposal. In addition, a separate category for transportation outlays financed by dedicated revenues would be established for 2007 through 2009 at levels consistent with those enacted in the Safe, Accountable, Flexible, Efficient, Transportation Equity Act: A Legacy for Users (SAFETEA–LU). The Administration would support expanding the defense category to include all security programs and a corresponding change to create a non-security category to ensure resources are devoted to security programs and are not diverted for other purposes.

*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 80 percent of improper payments are overpayments. The Administration has made the elimination of improper payments a major focus. Federal agencies have aggressively reviewed Federal



Table 15–2. DISCRETIONARY CAPS AND ADJUSTMENTS

(Amounts in billions of dollars)

	2007 <sup>1</sup>	2008	2009	2010	2011	2012
<b>Proposed Discretionary Spending Categories:</b>						
<b>Defense Category (Function 050):</b>						
Budget authority .....	455.8	501.9	531.4	NA	NA	NA
Outlays .....	536.2	479.0	546.2	NA	NA	NA
<b>Nondefense Category:</b>						
Budget authority .....	417.0	427.0	432.0	NA	NA	NA
Outlays .....	466.6	459.4	454.5	NA	NA	NA
<b>Discretionary Category:</b>						
Budget authority .....	NA	NA	NA	978.9	991.9	1,006.2
Outlays .....	NA	NA	NA	1,028.6	1,041.7	1,043.7
<b>Proposed Cap Adjustments:</b>						
<b>SSA Continuing Disability Reviews:</b>						
Budget authority .....	NA	0.213	0.453	0.485	NA	NA
Outlays .....	NA	0.213	0.453	0.485	NA	NA
<b>IRS Tax Enforcement:</b>						
Budget authority .....	NA	0.440	0.619	0.826	NA	NA
Outlays .....	NA	0.414	0.583	0.778	NA	NA
<b>Health Care Fraud and Abuse Control:</b>						
Budget authority .....	NA	0.183	0.198	0.211	NA	NA
Outlays .....	NA	0.183	0.198	0.211	NA	NA
<b>Unemployment Insurance Improper Payments:</b>						
Budget authority .....	NA	0.040	0.040	0.040	NA	NA
Outlays .....	NA	0.034	0.040	0.040	NA	NA
<b>Subtotal, Nondefense Category with Adjustments:</b>						
Budget authority .....	417.0	427.9	433.3	NA	NA	NA
Outlays .....	466.6	460.2	455.8	NA	NA	NA
<b>Highway Category:</b>						
Outlays .....	33.8	37.6	39.4	NA	NA	NA
<b>Mass Transit Category:<sup>2</sup></b>						
Outlays .....	7.5	8.7	9.8	NA	NA	NA
<b>Total, All Discretionary Categories:</b>						
Budget authority .....	872.8	929.8	964.7	980.4	991.9	1,006.2
Outlays .....	1,044.1	985.6	1,051.2	1,030.1	1,041.7	1,043.7
<b>Project BioShield Category:</b>						
Budget authority .....	.....	.....	2.2	.....	.....	.....
<i>Memorandum: 2007 Enacted Emergencies</i>						
Budget authority .....	72.0	.....	.....	.....	.....	.....

<sup>1</sup> The discretionary budget authority total is equal to the 302(a) allocation provided in a separate deeming provision in both the House and the Senate, excluding emergencies enacted for the Global War on Terror and for border security in the Department of Defense and Department of Homeland Security Appropriations Acts (P.L. 109–289 and P.L. 109–295, respectively). The House included a deeming provision in section 2 of the special rule, H. Res. 818, on the Department of Interior, Environment, and Related Agencies Appropriations Act for 2007. The Senate included a deeming provision in section 7035 of P.L. 109–234, the Emergency Supplemental Appropriations Act for Defense, the Global War on Terror, and Hurricane Recovery, 2006.

<sup>2</sup> Includes outlays from discretionary budget authority.

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 agencies' assessments have been aggregated into a Government-wide report entitled *Improving the Accuracy and Integrity of Federal Payments*. (The report can be found at [www.whitehouse.gov/omb/financial/fia-improper.html](http://www.whitehouse.gov/omb/financial/fia-improper.html).) In 2006, the agencies reported a total of \$40.5 billion in improper payments. This represents a 2.87 percent improper payment rate. Nearly 70 percent of those improper payments are in

four programs: Medicare, Earned Income Tax Credit, Old-Age, Survivors, and Disability Insurance, and Unemployment Insurance. This program integrity cap adjustment initiative also captures IRS efforts to improve tax compliance. While not technically improper payments, the challenges of tax compliance are similar to those of the improper payments programs.

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) and redeterminations of eligibility in the Social Security Administration (SSA), 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. The Administration's proposed adjustments for program integrity activities will total \$876 million in budget authority in 2008 and \$1,310 million in budget authority in 2009 and \$1,562 million in budget authority in 2010.

For the Social Security Administration, the \$213 million cap adjustment would allow SSA to conduct an additional 200,000 Continuing Disability Reviews (CDRs) and an additional 500,000 SSI redeterminations of eligibility in 2008. As a result of these efforts, SSA

would recoup over \$1.8 billion in savings over a ten-year period, with additional savings after the ten-year period, as estimated by SSA's Office of the Actuary. The savings from one year of program integrity activities are realized over multiple years because some CDRs identify that the beneficiary has medically improved and is capable of working, which may mean that they are no longer eligible to receive Disability Insurance (DI) or Supplemental Security Income (SSI) benefits. This may also result in savings in Medicare and Medicaid, since eligibility for these programs is linked to DI and SSI. Overpayments of SSI benefits identified by a redetermination are not always recovered in the same year that the redetermination is conducted.

The return on investment (ROI) for CDRs is approximately 10 to 1 in lifetime program savings, and approximately 8 to 1 over the first ten years. The ROI for redeterminations is approximately 7 to 1. Redeterminations focus on an individual's eligibility for the means tested SSI program and generally result in a revision to the individual's benefit level. However, the schedule of savings resulting from redeterminations will be different for the base and the cap adjustment. This is due to the fact that redeterminations of eligibility can uncover underpayment errors as well as overpay-

**Table 15-3. PROGRAM INTEGRITY BASE AND CAP ADJUSTMENTS**

(Budget authority in millions of dollars)

	2005 Actual	2006 Actual	2007		2008 Proposed	2009 Proposed	2010 Proposed
			Request	CR rate			
<b>SSA Continuing Disability Reviews:</b>							
Enforcement Base <sup>1</sup> .....	311	224	289	141	264	264	264
Cap Adjustments:							
BA .....	NA	NA	201	NA	213	453	485
Outlays .....	NA	NA	201	NA	213	453	485
<b>IRS Tax Enforcement:</b>							
Enforcement Base <sup>2</sup> .....	6,446	6,378	6,824	6,788	6,788	6,788	6,788
Cap Adjustments:							
BA .....	NA	446	137	NA	440	619	826
Outlays .....	NA	415	129	NA	414	583	778
<b>Health Care Fraud and Abuse Control Program:</b>							
Enforcement Base (Mandatory) .....	1,075	1,212	1,075	1,137	1,156	1,178	1,200
Cap Adjustments:							
BA .....	NA	NA	118	NA	183	198	211
Outlays .....	NA	NA	118	NA	183	198	211
<b>Unemployment Insurance Improper Payments:</b>							
Enforcement Base .....	10	10	10	10	10	10	10
Cap Adjustments:							
BA .....	NA	NA	40	NA	40	40	40
Outlays .....	NA	NA	34	NA	34	40	40
<b>Total:</b>							
Enforcement Base .....	7,842	7,824	8,198	8,063	8,218	8,240	8,262
Cap Adjustments:							
BA .....	NA	446	496	NA	876	1,310	1,562
Outlays .....	NA	415	482	NA	844	1,274	1,514

<sup>1</sup> The proposed 2008 base and cap adjustment would include both CDRs and redeterminations, whereas the 2005, 2006 and 2007 numbers reflect only CDRs, as previous cap adjustments were for CDRs only. In 2008, the base is \$161 million for CDRs and \$103 million for redeterminations, and the cap adjustment is \$163 million for CDRs and \$50 million for redeterminations. In 2009, the cap adjustment is \$346 million for CDRs and \$107 million for redeterminations. In 2010, the cap adjustment is \$368 million for CDRs and \$117 million for redeterminations. In 2009 and 2010 the split for the base is the same as in 2008.

<sup>2</sup> The enforcement base for the 2007 Request is equal to the 2006 enacted enforcement base of \$6,378 million plus the 2006 enacted cap adjustment of \$446 million.

ment errors. SSI recipients are more likely to initiate a redetermination of eligibility if they believe there is an underpayment error, and these recipient-initiated redeterminations are included in the base. In addition, corrections for underpayment errors are realized more quickly than corrections for overpayment errors.

SSA is required by law to conduct CDRs for all beneficiaries who are receiving Disability Insurance benefits, as well as all children under 18 who are receiving Supplemental Security Income. SSI redeterminations are also required by law, but the frequency is not specified in statute. Because of this mandate, in previous President's Budgets it was assumed that SSA devoted the resources necessary to carry out between 500,000 and 700,000 full medical CDRs and between 1 and 2 million SSI redeterminations per year, with resulting savings built into the baseline for SSI and DI. However, actual performance of program integrity activities has been well below this level. This year, the baseline assumes a more likely scenario for program integrity funding, and the President's Budget shows the savings which will result from the program integrity cap adjustment proposal.

For the IRS, the \$440 million cap adjustment covers cost increases (+\$149 million) for the \$6.8 billion base IRS enforcement program plus new investments in expanding staff and improving the efficiency of the IRS' enforcement programs (+\$291 million). As a result of

these efforts, the IRS will collect an estimated \$51 billion in 2007 in direct enforcement revenue. The IRS succeeded in increasing this figure by 44 percent between 2002 and 2006. The IRS estimates that work completed by the proposed new staff in 2008 will eventually yield another \$317 million. Once these new staff are trained and become more experienced the enforcement revenue impact of the work they complete each year will rise to \$699 million. However, this ROI estimate is understated because much of the new investment is directed towards efforts to improve the performance of the existing staff (such as new computers and better research) that are not reflected in the IRS' ROI calculation. More importantly, the ROI is understated because it does not reflect the impact enhanced enforcement has on deterring non-compliance that helps to ensure the continued payment of more than \$2 trillion in taxes voluntarily paid each year. The impact of increased IRS enforcement on improving voluntary compliance is not directly measured. However, research suggests it is at least three times as large as the direct impact on revenue.

The discretionary cap adjustment of \$183 million for the Centers for Medicare and Medicaid Services' HCFAC program is designed to provide additional resources to identify and reduce improper payments in the Medicare prescription drug benefit and Medicare Advantage programs. This \$183 million would build on

**Table 15-4. DIRECT SAVINGS ESTIMATED FROM 2008 PROGRAM INTEGRITY FUNDING**

(Budget authority in millions of dollars)

	2008 Program Integrity Funding	Direct Savings Estimates										
		2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Total
<b>SSA Continuing Disability Reviews<sup>1</sup></b>												
Enforcement Base .....	264	578	-608	-414	-250	-206	-200	-185	-169	-162	-142	-1,758
Cap Adjustment .....	213	-31	-439	-288	-188	-164	-158	-148	-137	-130	-118	-1,801
<b>IRS Tax Enforcement<sup>2</sup></b>												
Enforcement Base .....	6,788	-50,900										-50,900
Cap Adjustment <sup>3</sup> .....	440	-51	-194	-43	-14	-7	-4	-2	-1	-1		-317
<b>Health Care Fraud and Abuse Control Program</b>												
Cap Adjustments <sup>4</sup> .....	183	-330										-330
<b>Unemployment Insurance Improper Payments<sup>5</sup></b>												
Enforcement Base .....	10	-50										-50
Cap Adjustments .....	40	-145	-60									-205

<sup>1</sup> This is based on SSA's Office of the Actuary estimates of savings from CDRs and redeterminations. In the first year, the enforcement base shows a positive outlay. This is due to the fact that redeterminations of eligibility can uncover underpayment errors as well as overpayment errors. SSI recipients are more likely to initiate a redetermination if they believe there is an underpayment, and SSA completes these beneficiary-initiated redeterminations in the enforcement base. In addition, corrections for underpayments are realized more quickly than corrections for overpayment. The cap adjustment does not show an outlay in the first year because SSA would target their cap adjustment redetermination dollars to cases where an overpayment is suspected.

<sup>2</sup> Savings for IRS are revenue increases rather than spending reductions. They are shown as negatives for consistency in presentation. At the base level they are shown as constant for simplicity.

<sup>3</sup> The Internal Revenue Service (IRS) cap adjustment funds cost increases for the base program (+\$149 million) and new initiatives (+\$291 million). The IRS collects \$51 billion per year (2007 estimate) in direct enforcement revenue, and its enforcement program helps maintain the more than \$2 trillion in taxes voluntarily paid each year. The cost increases will help maintain the base revenue. The 2008 initiatives will yield an estimated \$317 million in new enforcement revenue, fund improvements in the base program such as new computers and better research, and help deter tax cheating. This deterrence impact is not directly measured. However, research suggests it is at least three times as large as the direct impact on revenue.

<sup>4</sup> These data are based on estimates from the HHS Office of the Actuary for return on investment from program integrity activities.

<sup>5</sup> The maximum UI benefit period is typically 26 weeks. As a result, preventing an ineligible individual from collecting UI benefits would save at most a half year of benefits. The two years of savings reflect the fact that reemployment and eligibility assessments conducted late in the year affect individuals whose benefits would have continued into the subsequent fiscal year.

**Table 15–5. TRANSPORTATION CATEGORY FOR HIGHWAYS AND MASS TRANSIT SPENDING**

(Amounts in millions of dollars)

	2007	2008	2009
<b>Transportation Category:<sup>1</sup></b>			
Highways: <sup>2</sup>			
Obligation Limitations .....	36,847	40,946	42,581
Outlays .....	33,840	37,649	39,443
Mass Transit:			
Obligation Limitations .....	6,910	7,873	8,406
Outlays <sup>3</sup> .....	7,479	8,740	9,774
<b>Memorandum:</b>			
<i>Discretionary budget authority for Mass Transit included in the Nondefense Category:</i>			
<i>Budget authority .....</i>	1,688	1,550	1,980

<sup>1</sup> The amounts included for 2007 reflect the levels provided by the continuing resolution (P.L. 109–289, Division B, as amended). The SAFETEA–LU levels enacted for Highway and Mass Transit programs apply in 2008 and 2009.

<sup>2</sup> The Highway levels do not include adjustments authorized in SAFETEA–LU of \$631 million in FY 2008 for the revenue aligned budget authority (RABA) calculation. The levels do include \$122 million in FY 2008–2009 for the National Highway Traffic Safety Administration. The proposal is to fund NHTSA completely from the Highway Trust Fund instead of a portion from General Fund, as authorized in SAFETEA–LU.

<sup>3</sup> Includes outlays from discretionary budget authority.

funding provided in the Deficit Reduction Act of 2005 for Part D program integrity activities for FY 2006 only. The funding would be allocated among CMS, the Health and Human Services Office of Inspector General, the Federal Bureau of Investigation, and Department of Justice to safeguard these programs as well as Medicaid against fraud and abuse. This \$183 million would generate approximately \$330 million in savings in FY 2008, which would reflect recouping improper payments made to providers.

The 2008 Budget proposes a discretionary cap adjustment of \$40 million for the Department of Labor’s (DOL) Unemployment Insurance (UI) State administrative grants program to reduce UI improper payments, a top management challenge identified by GAO and DOL’s Inspector General. The proposal would expand a \$10 million Reemployment and Eligibility Assessment initiative begun in 2005 to finance in-person interviews at One-Stop Career Centers to assess UI beneficiaries’ need for job-finding services and their continued eligibility for benefits. The current \$10 million effort results in a savings in UI benefit payments of \$50 million. The maximum UI benefit period is typically 26 weeks. As a result, preventing an ineligible individual from collecting UI benefits would save at most a half year of benefits. The two years of savings from the additional \$40 million, totaling \$145 million in 2008 and \$60 million in 2009, reflect the fact that reemployment and eligibility assessments conducted late in the year affect individuals whose benefits would have continued into the subsequent fiscal year.

*Transportation Category.*—The Administration’s proposal for discretionary caps includes separate outlay categories for spending on Federal Highway and Mass Transit programs. The transportation levels will be financed by dedicated revenues through 2009. Table 15–5 shows the levels, excluding the revenue aligned budget

authority (RABA) adjustment as authorized in SAFETEA–LU for 2007 and 2008. 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. The amounts shown for 2007 reflect the levels provided by the continuing resolution (P.L. 109–289, Division B, as amended), which did not include the 2007 RABA adjustment authorized in SAFETEA–LU. For 2008, the RABA adjustment authorized in SAFETEA–LU is a positive \$631 million; however, the Administration proposes not to provide this increase in funding in order to preserve the solvency of the Highway Trust Fund.

*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 spending 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 2001 Congressional Budget Resolution and this Administration’s budget proposals have 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 2009, the Administration proposes a cap on advance appropriations of \$23,174 million.

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 2009 that is in excess of the Administration's limit on advance appropriations of \$23,174 million in 2009 will count against the discretionary cap in the year enacted, not against the year the funds first become available.

*For more information on individual accounts with advance appropriations, please see the chapter on this subject in the Budget Appendix.*

**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 2008 Budget, the Department of Education estimates that a cumulative \$235 million shortfall will be carried into the 2008–2009 academic year. Because there is no final 2007 appropriation for this account, the Budget assumes a 2007 enacted level of \$12.607 billion for calculating this shortfall, which was the CBO estimate of the 2007 Senate Subcommittee appropriation of a \$4,050 maximum

award for the 2007–2008 award year. For scoring purposes, the funding needed to fully fund all awards for 2008–2009 is increased by the amount of this shortfall.

**Project BioShield Category.**—The Administration proposes a separate BEA category for budget authority for Project BioShield, which received an advance appropriation 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 enacted in 1990, 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, tor-

nados, 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 supports the extension of section 257 of the BEA governing baseline calculations with the following changes:

- 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.

### Earmark Reform

An earmark is a spending provision that the Congress inserts in legislation. Frequently, these provisions are not publicly disclosed during the legislative process and often they are special interest projects. A number of organizations track earmarks. The Congressional Research Service (CRS) and Citizens Against Government Waste (CAGW) have been tracking earmarks for over a decade. While they do not use the same definition, their data show similar trends. Earmarks have expanded dramatically in recent years, with the numbers and costs of earmarks more than tripling since the early 1990s. According to CAGW, the Congress added nearly 550 earmarks at a cost of \$3 billion to the Budget in 1991. The number of earmarks peaked in 2005. CAGW has estimated that earmarks grew to almost 14 thousand at a cost of \$27 billion. CRS data show a similar trend, with earmarks reaching more than 16 thousand in 2005 at a cost of \$52 billion. OMB has also been tracking earmarks during recent years and estimates that the number of earmarks grew to over 13 thousand at a cost of nearly \$18 billion. OMB is

in the process of developing the capability to track earmarks during the legislative process.

One major concern about earmarks is the lack of transparency. Most earmarks do not appear in statutory language. Instead, they are included in committee reports that accompany legislation. According to CRS, more than 90 percent of earmarks are in report language. This means that the vast majority of earmarks do not appear in the statutory language that the Congress actually votes on or that the President signs into law. Also, earmarks frequently surface in the last stage of the legislative process, in conference committees between the House and the Senate.

The President has called on the Congress to fully disclose all earmarks to reduce the amount of wasteful and unnecessary spending. Taxpayers should feel confident that their tax dollars are being spent wisely. Unfortunately, the large number of earmarks and the lack of transparency in the earmarking process make it difficult to assure the public that the Government is spending the people's money on the Nation's highest priorities. The President has proposed that the Congress provide justification for earmarks, and identify the sponsor, costs, and recipients of each project. In addition, the President has proposed that the Congress stop the practice of placing earmarks in report language. Finally, he has called on the Congress to cut the number and cost of earmarks by at least 50 percent.

### Line-Item Veto

A perennial criticism of the Federal Government is that spending and tax legislation contain too many provisions that are not fully justified, are a low priority, or are earmarked to avoid the discipline of competitive or merit-based reviews. These special interest items would likely not become law if considered as a stand-alone bill, and their persistence diverts resources from higher priority programs and erodes the confidence of citizens in Government.

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.

Last year, the President asked that Congress correct this state of affairs by providing him and future presidents with a line item veto that would withstand constitutional challenge, and the President transmitted legislation to the Congress in March 2006 that accomplishes this purpose. Under the President's proposal, a President could propose legislation to rescind wasteful spending, and the Congress would be obligated to vote quickly on that package of rescissions, without amendment. All savings from the line-item veto would be used

for deficit reduction; they could not be applied to augment spending elsewhere.

The President's proposal received strong support. In June 2006, the House of Representatives voted on a bipartisan basis to enact a version of the Legislative Line Item Veto. In the Senate, members voted to report an amended version of the President's proposal out of the Senate Budget Committee for consideration on the floor.

Forty-three Governors have a line item veto to reduce spending, and the President needs similar authority to help control unjustified and wasteful spending in the Federal budget. The Administration urges continued support for this common-sense provision and will seek its enactment in the 110th Congress.

### 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 three times 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, in recent years the Congress appropriated between \$160 billion and \$170 billion 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 22 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 author-

ity 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, in June 2005 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. The legislation was introduced in the House and Senate, but was not enacted.



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## FEDERAL BORROWING AND DEBT

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## 16. FEDERAL BORROWING AND DEBT

Debt is the largest legally binding obligation of the Federal Government. At the end of 2006, the Government owed \$4,829 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 \$237 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: <sup>3</sup>	
	Current Dollars	FY 2000 dollars <sup>1</sup>	GDP	Credit market debt <sup>2</sup>	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	33.7	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	19.1	13.0	2.4
2001 .....	3,319.6	3,243.1	33.0	17.6	11.6	2.1
2002 .....	3,540.4	3,393.9	34.1	17.6	8.9	1.7
2003 .....	3,913.4	3,677.1	36.2	17.9	7.5	1.5
2004 .....	4,295.5	3,934.3	37.3	18.1	7.3	1.5
2005 .....	4,592.2	4,081.7	37.4	17.7	7.7	1.6
2006 .....	4,829.0	4,163.7	37.0	17.2	8.9	1.8
2007 estimate .....	5,083.3	4,274.5	36.9	N/A	9.0	1.8
2008 estimate .....	5,345.4	4,388.8	36.8	N/A	9.6	1.9
2009 estimate .....	5,553.6	4,458.1	36.3	N/A	9.8	1.9
2010 estimate .....	5,671.2	4,456.2	35.2	N/A	9.9	1.9
2011 estimate .....	5,748.3	4,425.7	33.9	N/A	9.8	1.8
2012 estimate .....	5,711.1	4,311.2	32.1	N/A	9.7	1.8

N/A=Not available.

<sup>1</sup>Debt in current dollars deflated by the GDP chain-type price index with Fiscal Year 2000 equal to 100.

<sup>2</sup>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.

<sup>3</sup>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 \$248 billion in 2006, down from \$318 billion in 2005. This \$248 billion deficit, partially offset by other financing transactions totaling \$11 billion, required the Government to increase its borrowing from the public by \$237 billion last year. Debt held by the public fell from 37.4 percent of Gross Domestic Product (GDP) at the end of 2005 to 37.0 percent of GDP at the end of 2006. The deficit is estimated to continue to fall, with the Federal Government achieving surplus in 2012. Debt as a percentage of GDP is also estimated to continue to fall, reaching 32.1 percent of GDP in 2012.

### 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 2012. (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.) 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 rising 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 17.6 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 in 2002 as economic conditions changed following the September 11 terrorist attacks. 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 due to the Global War on Terror. Consequently, deficits ensued and debt began to rise, both in nominal terms and as a percentage of GDP. However, a growing economy led to a revival of receipts and deficits fell in 2005 and 2006. Deficits are expected to continue to fall in 2007 through 2012. In nominal dollars, debt is estimated to continue to rise through 2011 and then to begin to fall in 2012 when the Government achieves surplus. Debt as a percent of GDP fell in 2006 and is expected to fall by nearly five percentage points by the end of 2012.

### 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.<sup>1</sup> Second, it issues debt to Government accounts, primarily trust funds, that accumulate surpluses. (As used in this Budget, debt held by Government accounts refers to debt held by Federal Government accounts; investments by State and local governments in Federal securities are included as debt held by the public.) 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.”<sup>2</sup>

Borrowing from the public, whether by the Treasury or by some other Federal agency, is normally a good approximation of the Federal demand on credit markets. Regardless of whether the proceeds are used for tangible or intangible investment or to finance current consumption, 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 amount of saving imported from abroad. It also increases the amount

<sup>1</sup>Treasury debt held by the public is 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 the principal amount due at maturity (par or face value) less the unamortized discount. (For a security sold at a premium, the definition is symmetrical.) For inflation-indexed notes and bonds, the book value includes a periodic adjustment for inflation. Agency debt is generally recorded at par.

<sup>2</sup>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 2006	Estimate					
		2007	2008	2009	2010	2011	2012
<b>Financing:</b>							
Unified budget deficit (-)/surplus (+) .....	-248.2	-244.2	-239.4	-187.2	-94.4	-53.8	61.0
Financing other than borrowing from the public:							
Net purchases of non-Federal securities by the National Railroad Retirement Investment Trust (-) .....	-1.8	-0.9	*	*	0.2	0.6	0.3
Changes in: <sup>1</sup>							
Treasury operating cash balance (-) .....	-16.4	7.1					
Checks outstanding, etc. <sup>2</sup> .....	12.7						
Seigniorage on coins .....	0.7	0.8	0.7	0.6	0.5	0.5	0.5
Credit net financing disbursements (-):							
Direct loan financing accounts .....	-4.7	-10.6	-16.7	-14.7	-18.0	-19.1	-20.5
Guaranteed loan financing accounts .....	21.0	-6.6	-6.8	-7.0	-5.9	-5.4	-4.2
Total, financing other than borrowing from the public .....	11.4	-10.1	-22.8	-21.0	-23.2	-23.3	-23.8
Total, requirement to borrow from the public .....	-236.8	-254.3	-262.2	-208.2	-117.5	-77.1	37.2
Change in debt held by the public .....	236.8	254.3	262.2	208.2	117.5	77.1	-37.2
<b>Changes in Debt Subject to Limitation:</b>							
Change in debt held by the public .....	236.8	254.3	262.2	208.2	117.5	77.1	-37.2
Change in debt held by Government accounts .....	309.3	302.1	305.6	354.6	381.7	400.1	409.7
Less: change in debt not subject to limit and other adjustments .....	3.2	0.2	0.6	2.6	2.4	2.5	2.1
Total, change in debt subject to statutory limitation .....	549.2	556.6	568.3	565.5	501.7	479.7	374.6
<b>Debt Subject to Statutory Limitation, End of Year:</b>							
Debt issued by Treasury .....	8,425.6	8,982.2	9,550.5	10,113.9	10,613.8	11,091.8	11,465.0
Less: Treasury debt not subject to limitation (-) <sup>3</sup> .....	-14.5	-14.5	-14.5	-12.4	-10.7	-8.9	-7.6
Agency debt subject to limitation .....	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Adjustment for discount and premium <sup>4</sup> .....	9.1	9.1	9.1	9.1	9.1	9.1	9.1
Total, debt subject to statutory limitation <sup>5</sup> .....	8,420.3	8,976.9	9,545.2	10,110.6	10,612.3	11,092.0	11,466.6
<b>Debt Outstanding, End of Year:</b>							
Gross Federal debt: <sup>6</sup>							
Debt issued by Treasury .....	8,425.6	8,982.2	9,550.5	10,113.9	10,613.8	11,091.8	11,465.0
Debt issued by other agencies .....	25.8	25.6	25.0	24.5	23.7	23.0	22.3
Total, gross Federal debt .....	8,451.4	9,007.8	9,575.5	10,138.3	10,637.6	11,114.8	11,487.3
Held by:							
Debt held by Government accounts .....	3,622.4	3,924.5	4,230.1	4,584.7	4,966.4	5,366.5	5,776.2
Debt held by the public <sup>7</sup> .....	4,829.0	5,083.3	5,345.4	5,553.6	5,671.2	5,748.3	5,711.1

<sup>1</sup> 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.

<sup>2</sup> 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.

<sup>3</sup> Consists primarily of Federal Financing Bank debt.

<sup>4</sup> 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.

<sup>5</sup> The statutory debt limit is \$8,965 billion, enacted on March 20, 2006.

<sup>6</sup> 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).

<sup>7</sup> At the end of 2006, the Federal Reserve Banks held \$768.9 billion of Federal securities and the rest of the public held \$4,060.0 billion. Debt held by the Federal Reserve Banks is not estimated for future years.

of future resources required to pay interest to the public on Federal debt. Borrowing from the public is therefore an important concern of Federal fiscal policy.<sup>3</sup>

<sup>3</sup>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."

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 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 credit market 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 other resources.

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.<sup>4</sup>

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 the year 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

<sup>4</sup> 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.

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 gauge of the effect of the budget on the credit markets than gross Federal debt.

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 2006 through 2012. In 2006 the Government borrowed \$237 billion, increasing the debt held by the public from \$4,592 billion at the end of 2005 to \$4,829 billion at the end of 2006. The debt held by Government accounts increased \$309 billion, and gross Federal debt increased by \$546 billion to \$8,451 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.<sup>5</sup> The off-budget totals are virtually the same as Social Security, which had a large surplus in 2006 and is estimated to have large surpluses throughout the projection pe-

<sup>5</sup> For further explanation of the off-budget Federal entities, see Chapter 23 of this volume, "Off-Budget Federal Entities and Non-Budgetary Activities."

riod. The on-budget and off-budget surpluses or deficits are added together to determine the Government's financing needs.

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 borrowing from 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 2006 the deficit was \$248 billion and the “financing other than borrowing from the public” was \$11 billion. As a result, the Government borrowed \$237 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 \$2,945 billion and the increase in debt held by the public was \$3,088 billion. Thus, the other factors added a total of \$143 billion of borrowing, an average of \$7 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 2007 through 2012, by amounts ranging from \$10 billion in 2007 to \$24 billion in 2012. 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 smaller, with a \$1 billion increase in 2004 and a \$1 billion decrease in 2005. The cash balance increased \$16 billion in 2006. The operating cash balance is estimated to decrease by \$7 billion by the end of 2007 and then to remain essentially the same. 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. In 2003, most of the assets in the Railroad Retirement Board trust

funds were transferred to the new trust fund, 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 borrowing from the public” rather than included as an increase in the deficit. This increased borrowing expanded publicly held debt by \$20 billion in 2003. Net purchases have been relatively small since 2003 and are estimated to remain relatively small in future years.<sup>6</sup>

*Net financing disbursements of the direct loan and guaranteed loan financing accounts.*—Under the Federal Credit Reform Act of 1990, 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.<sup>7</sup>

The financing accounts also include several types of intragovernmental 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 re-

<sup>6</sup>The budget treatment of this fund is further discussed in Chapter 26 of this volume, “The Budget System and Concepts.”

<sup>7</sup>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.

ceipts 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 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 2005 and 2006, 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. In 2007, net downward reestimates are expected and financing accounts will make positive net financing disbursements of the downward reestimates to receipt accounts. After 2007, the pattern is expected to be more normal. The financing accounts are estimated to increase the need for borrowing by \$17 billion in 2007 and from \$22 billion to \$25 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.

**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 93 percent of the total Federal debt held by Government accounts at the end of 2006. In 2006, the total trust fund surplus was \$289 billion, and trust funds invested \$278 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

Some Federal agencies, shown in Table 16-3, sell or have sold debt securities to the public and, at times, to other Government accounts. At one time, several other agencies issued debt securities, but this activity has declined significantly over time. Currently, new debt is issued only by the Tennessee Valley Authority (TVA) and the Federal Housing Administration (FHA); the remaining agencies are repaying existing borrowing. During 2006, agencies repaid \$0.4 billion of debt held by the public, resulting in total agency debt of \$25.8 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 2007 and 2008.

**Table 16-3. AGENCY DEBT**

(In millions of dollars)

	Borrowing or repayment (-) of debt			Debt end of 2008 estimate
	2006 actual	2007 estimate	2008 estimate	
<b>Borrowing from the public:</b>				
Housing and Urban Development:				
Federal Housing Administration .....	-34	*	.....	112
Small Business Administration:				
Participation certificates: Section 505 development company .....		-7	.....	.....
Architect of the Capitol .....	-3	-4	-4	148
National Archives .....	-9	-10	-11	204
Tennessee Valley Authority:				
Bonds and notes .....	-205	-11	-388	22,493
Lease/leaseback obligations .....	-34	-37	-43	1,029
Prepayment obligations .....	-106	-105	-106	1,033
<b>Total, borrowing from the public .....</b>	<b>-391</b>	<b>-174</b>	<b>-552</b>	<b>25,019</b>
<b>Borrowing from other funds:</b>				
Tennessee Valley Authority .....	6	.....	.....	7
<b>Total, borrowing from other funds .....</b>	<b>6</b>	.....	.....	<b>7</b>
<b>Total, agency borrowing .....</b>	<b>-385</b>	<b>-174</b>	<b>-552</b>	<b>25,026</b>

\* \$500,000 or less.



The predominant agency borrower is the Tennessee Valley Authority, which had borrowed \$25 billion from the public as of the end of 2006, or 98 percent of the total debt of all agencies. TVA sells debt primarily to finance capital expenditures.

The TVA has traditionally financed its capital construction by selling bonds and notes to the public. Since 2000, it has also employed two types of alternative financing methods, lease/leaseback obligations and prepayment obligations. The Office of Management and Budget determined that each of these methods is a means of financing the acquisition of assets owned and used by the Government, or of refinancing 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 budget therefore records the upfront cash proceeds from these methods as borrowing from the public, not offsetting collections. The obligations under these methods are reported as liabilities on TVA's balance sheet under generally accepted accounting principles. Table 16-3 presents these alternative financing methods separately from TVA bonds and notes to distinguish between the types of borrowing.

The first type of alternative financing method is 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. The arrangement is at least as governmental as a "lease-purchase without substantial private risk."<sup>8</sup> The same budget treatment was applied to the lease/leaseback of qualified technological equipment in 2003. The obligations for lease/leasebacks were \$1.1 billion at the end of 2006 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 entered into a 15-year, \$1.5 billion contract with Memphis Light, Gas, and Water (MLGW) in 2004. The prepayment obligations

were \$1.2 billion at the end of 2006 and are estimated to continue to decline as TVA provides electric power under the contracts.

The Federal Housing Administration 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. 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 borrowing. The debentures are therefore classified as agency debt.

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. These arrangements are equivalent to direct Federal construction financed by Federal borrowing. The construction expenditures and interest were therefore classified as Federal outlays, and the borrowing was classified as Federal agency borrowing from the public.

The amount of agency securities sold to the public has been reduced over time 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 \$309 billion in 2006, and is estimated to be \$302 billion in 2007 and \$306 billion in 2008, as shown in Table 16-4. The holdings of Federal securities by Government accounts are estimated to grow to \$4,230 billion by the end of 2008, or 44 percent of the gross Federal debt. The percentage is estimated to rise in the following years, as the trust funds and several major revolving funds and special funds continue to accumulate surpluses while borrowing from the public begins to fall.

<sup>8</sup>For further detail on the current budgetary treatment of lease-purchase without substantial private risk, 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."

**Table 16-4. DEBT HELD BY GOVERNMENT ACCOUNTS<sup>1</sup>**  
(In millions of dollars)

Description	Investment or Disinvestment (-)			Holdings end of 2008 estimate
	2006 actual	2007 estimate	2008 estimate	
<b>Investment in Treasury debt:</b>				
Energy:				
Nuclear waste disposal fund <sup>1</sup> .....	1,044	57	874	19,653
Uranium enrichment decontamination fund .....	337	321	112	4,661
Health and Human Services:				
Federal hospital insurance trust fund .....	24,919	11,858	3,341	317,385
Federal supplementary medical insurance trust fund .....	15,857	8,794	6,325	48,180
Vaccine injury compensation fund .....	214	-77	-87	2,216
Homeland Security: Aquatic resources trust fund .....	100	15	-363	1,301
Housing and Urban Development:				
Federal Housing Administration mutual mortgage fund .....	-612	-597	217	21,650
Guarantees of mortgage-backed securities .....	436	336	349	9,070
Interior:				
Bureau of Land Management permanent operating funds .....	622	70	54	2,465
Environmental improvement and restoration fund .....	39	51	51	1,153
Abandoned mine reclamation fund .....	131	112	112	2,490
Labor:				
Unemployment trust fund .....	11,407	12,787	12,000	91,000
Pension Benefit Guaranty Corporation <sup>1</sup> .....	2,618	-8,985	-456	5,546
State: Foreign service retirement and disability trust fund .....	516	-477	134	13,533
Transportation:				
Highway trust fund .....	2,727	2,210	-1,628	11,580
Airport and airway trust fund .....	-2,154	-667	-158	7,068
Treasury: Exchange stabilization fund .....	473	346	353	16,410
Veterans Affairs:				
National service life insurance trust fund .....	-409	-478	-531	9,180
Veterans special life insurance fund .....	32	12	-17	1,955
Corps of Engineers: Harbor maintenance trust fund .....	542	421	520	4,105
Other Defense-Civil:				
Medicare-eligible retiree health care fund .....	19,867	23,471	24,076	120,287
Military retirement trust fund .....	4,528	27,072	7,582	216,464
Education benefits fund .....	216	141	148	1,530
Environmental Protection Agency:				
Hazardous substance trust fund .....	315	-9	.....	2,631
Leaking underground storage tank trust fund .....	229	230	230	3,126
International Assistance Programs:				
Overseas Private Investment Corporation .....	244	95	140	4,508
Office of Personnel Management:				
Civil service retirement and disability trust fund .....	29,186	9,296	30,148	729,380
Employees life insurance fund .....	1,797	1,400	1,669	34,351
Employees health benefits fund .....	2,292	1,553	709	17,087
Postal Service retiree health benefits fund .....	.....	31,358	6,883	38,241
Social Security Administration:				
Federal old-age and survivors insurance trust fund <sup>2</sup> .....	176,971	180,187	203,556	2,176,872
Federal disability insurance trust fund <sup>2</sup> .....	8,915	4,156	5,698	212,032
District of Columbia: Federal pension fund .....	-20	-5	12	3,616
Farm Credit System Insurance Corporation:				
Farm Credit System Insurance fund .....	150	270	213	2,571
Federal Communications Commission: Universal service fund .....	605	-*	.....	4,762
Federal Deposit Insurance Corporation:				
Federal deposit insurance fund .....	1,158	1,542	2,579	50,337
FSLIC resolution fund .....	-94	246	294	3,569
National Credit Union Administration: Share insurance fund .....	326	251	376	7,376
Postal Service fund <sup>2</sup> .....	3,015	-3,088	.....	1,145
Railroad Retirement Board trust funds .....	-109	161	79	2,131
Other Federal funds .....	1,139	-2,191	-9	5,095
Other trust funds .....	32	-139	-13	4,302
Unrealized discount <sup>1</sup> .....	-317	.....	.....	-1,962
<b>Total, investment in Treasury debt<sup>1</sup> .....</b>	<b>309,285</b>	<b>302,108</b>	<b>305,572</b>	<b>4,230,051</b>

**Table 16-4. DEBT HELD BY GOVERNMENT ACCOUNTS<sup>1</sup>—Continued**  
(In millions of dollars)

Description	Investment or Disinvestment (–)			Holdings end of 2008 estimate
	2006 actual	2007 estimate	2008 estimate	
<b>Investment in agency debt:</b>				
Railroad Retirement Board:				
National Railroad Retirement Investment Trust .....	6	.....	.....	7
<b>Total, investment in agency debt<sup>1</sup></b> .....	<b>6</b>	.....	.....	<b>7</b>
<b>Total, investment in Federal debt<sup>1</sup></b> .....	<b>309,291</b>	<b>302,108</b>	<b>305,572</b>	<b>4,230,058</b>
<b>MEMORANDUM</b>				
Investment by Federal funds (on-budget) .....	28,463	46,748	36,230	323,460
Investment by Federal funds (off-budget) .....	3,015	–3,088	.....	1,145
Investment by trust funds (on-budget) .....	92,245	74,105	60,088	1,518,512
Investment by trust funds (off-budget) .....	185,886	184,343	209,254	2,388,904
Unrealized discount <sup>1</sup> .....	–317	.....	.....	–1,962

\* \$500 thousand or less.

<sup>1</sup> 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, at the end of 2006 the debt figures would be \$17.8 billion higher for the Nuclear Waste Disposal fund and \$21.6 billion higher for PBGC than recorded in this table.

<sup>2</sup> Off-budget Federal entity.

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 \$579 billion during 2006–08, which is 63 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 Fund (CSRDF). In 2007, funds are being transferred from the CSRDF, the Postal Service, and other sources to create a new special fund for Postal Service retiree health benefits. Together the CSRDF and the new Postal Service retiree health benefit fund account for 12 percent of the total investment by Government accounts during 2006–08. The military retirement trust fund and the special fund for uniformed services Medicare-eligible retiree health care account for another 12 percent. The two Medicare trust funds—Hospital Insurance and Supplementary Medical Insurance—account for another 8 percent. Altogether, the investment by Social Security, Medicare, and these four Federal employee retirement funds is almost as much as the total investment by Government accounts during this period. At the end of 2008, they are estimated to own 94 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 re-

corded at par in the OMB and Treasury reports on Federal debt. However, there are two kinds of exceptions.

First, Treasury issues 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 \$39.4 billion at the end of 2006.

Second, Treasury subtracts 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 \$2.0 billion at the end of 2006.

### 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 other Treasury debt not subject to the general limit consists almost entirely of silver certificates and other currencies no longer being issued. It was \$506 million at the end of 2006 and gradually declines over time.

The sole agency debt currently subject to the general limit, \$96 million at the end of 2006, is certain debentures issued by the Federal Housing Administration.<sup>9</sup> 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: \$9.1 billion at the end of 2006 compared to the total unamortized discount (less premium) of \$81.4 billion on all Treasury securities.

**Changes in the debt limit.**—The statutory debt limit has been changed many times. Since 1960, Congress has passed 72 separate acts to raise the limit, extend the duration of a temporary increase, or revise the definition.<sup>10</sup>

During the 1990s, 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. The 1997 increase lasted until 2002.

Since 2002, the debt has reached the limit four times. In each instance, the limit has been increased by an amount sufficient to last less than two years. The debt limit was increased to \$6,400 billion on June 28, 2002, to \$7,384 billion on May 27, 2003, to \$8,184 billion on November 19, 2004, and to \$8,965 billion on March 20, 2006. Each time, in the weeks prior to the increase, the Treasury Department has taken a variety of administrative actions to meet the Government's obligation to pay its bills and invest its trust funds while keeping debt under the existing limit.

In the months leading to the most recent increase, the Secretary of Treasury wrote Congress in December 2005 that the debt subject to limit would reach the ceiling in February 2006. It did reach the limit on February 16 and stayed there until the limit was increased.

On February 16, 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 Plan, 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. 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, 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, as authorized by law. The Exchange Stabilization fund was disinvested. The Secretary also declared a debt issuance suspension period from March 6 to May 26. This allowed him to redeem a limited amount of securities held by the Civil Service Retirement and Disability Fund and stop investing its receipts.

These Treasury actions were used for a little more than one month. Congress passed a bill raising the debt limit to \$8,965 billion on March 16, and the President signed the bill on March 20. Treasury promptly invested the G-fund and Civil Service Retirement and Disability Fund fully and restored the forgone interest as prescribed by law. Treasury also fully invested the Exchange Stabilization fund and reinstated acceptance of subscriptions to the State and local government series.

All the steps taken during February or March had also been taken on previous occasions when the debt

<sup>9</sup>At the end of 2006, \$16 million of FHA debentures was not subject to limit.

<sup>10</sup>The Acts and the statutory limits since 1940 are listed in *Historical Tables, Budget of the United States Government, Fiscal Year 2008*, Table 7.3.

had reached the statutory limit, including in 2002, 2003, or 2004. In addition, Treasury has previously replaced regular Treasury securities with borrowing by the Federal Financing Bank, which, as explained above, is not subject to the debt limit. On November 15, 2004, prior to the November 19 debt limit increase, the Federal Financing Bank issued \$14 billion of FFB securities to the Civil Service Retirement and Disability Fund in exchange for an equal amount of regular Treasury securities. FFB then exchanged those regular Treasury securities with Treasury at market value in return for the extinguishment of an equal market value of FFB debt owed to Treasury. As indicated above, the FFB securities issued to CSRDF begin to mature in June 2009. When the debt limit was reached in 2002 and 2003, Treasury also reduced its compensating balances—deposits held in banks to pay for services under financial agency agreements. However, compensating balances were discontinued in 2004.

**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.

**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 over two-thirds of the estimated total increase from 2007 through 2012.

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.<sup>11</sup>

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 deficit or 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. The trust fund surplus reduces the total budget deficit or increases the total budget surplus, decreasing the need to borrow from the public or increasing the ability to repay borrowing from the public. When the trust fund surplus is invested in Federal securities, the debt held by Government accounts increases, offsetting the decrease in debt held by the public by an equal amount. Thus, there is no net effect on gross Federal debt.

Table 16–5 derives the change in debt subject to limit. In 2006 the Federal funds deficit was \$537 billion, and other factors reduced financing requirements by \$13 billion. The net financing disbursements of the guaranteed loan financing accounts reduced the financing requirements by \$16 billion, as explained in an earlier section. As an offset, special funds and revolving funds, which are part of the Federal funds group, invested \$31 billion in Treasury securities. The largest single investment was \$20 billion for the uniformed services Medicare-eligible retiree health care fund. In addition, an adjustment is made for the relatively minor difference between the trust fund surplus and the trust funds' investment in Federal securities (including the changes in the National Railroad Retirement Investment Trust's investments in non-Federal securities). As a net result of all these factors, \$546 billion in financing was required. Therefore, gross Federal debt increased by \$546 billion. Since Federal debt not subject to limit decreased by \$0.4 billion and the adjustment for discount and premium changed by \$2.8 billion, the debt subject to limit increased by \$549 billion, while debt held by the public increased by \$237 billion.

<sup>11</sup> For further discussion of the trust funds and Federal funds groups, see Chapter 22 of this volume, "Trust Funds and Federal Funds."

The debt subject to limit is estimated to increase to \$8,977 billion by the end of 2007, which exceeds the present statutory debt limit of \$8,965 billion. (This estimate does not reflect any administrative actions that Treasury might take to meet the Government's obligations while staying within the statutory limit.)

The estimated increases in the debt subject to limit are caused by the continued Federal funds deficit, supplemented by the other factors shown in Table 16-5. While debt held by the public increases by \$882 billion from the end of 2006 through 2012, debt subject to limit increases by \$3,046 billion.

**Table 16-5. FEDERAL FUNDS FINANCING AND CHANGE IN DEBT SUBJECT TO STATUTORY LIMIT**

(In billions of dollars)

Description	Actual 2006	Estimate					
		2007	2008	2009	2010	2011	2012
<b>Change in Gross Federal Debt:</b>							
Federal funds deficit (-) .....	-537.3	-489.7	-533.3	-498.2	-428.9	-403.1	-296.7
Means of financing other than borrowing—Federal funds <sup>1</sup> .....	13.2	-9.3	-22.8	-21.0	-23.4	-24.0	-24.1
Decrease or increase (-) in Federal debt held by Federal funds .....	-31.5	-43.7	-36.2	-43.6	-47.2	-50.8	-52.0
Adjustments for trust fund surplus not invested in Federal securities <sup>2</sup> .....	9.2	-13.7	24.6	*	0.2	0.6	0.3
Less: change in unrealized discount on Federal debt held by Federal funds .....	-0.3	.....	.....	.....	.....	.....	.....
<b>Total financing requirements</b> .....	<b>-546.1</b>	<b>-556.4</b>	<b>-567.7</b>	<b>-562.8</b>	<b>-499.3</b>	<b>-477.2</b>	<b>-372.5</b>
<b>Change in Debt Subject to Limit:</b>							
Change in gross Federal debt .....	546.1	556.4	567.7	562.8	499.3	477.2	372.5
Less: increase or decrease (-) in Federal debt not subject to limit .....	-0.4	-0.2	-0.6	-2.6	-2.4	-2.5	-2.1
Less: change in adjustment for discount and premium <sup>3</sup> .....	-2.8	.....	.....	.....	.....	.....	.....
<b>Total, change in debt subject to limit</b> .....	<b>549.2</b>	<b>556.6</b>	<b>568.3</b>	<b>565.5</b>	<b>501.7</b>	<b>479.7</b>	<b>374.6</b>
<b>ADDENDUM</b>							
Debt subject to statutory limit <sup>4</sup> .....	8,420.3	8,976.9	9,545.2	10,110.6	10,612.3	11,092.0	11,466.6

\* \$50 million or less.

<sup>1</sup> Includes Federal fund transactions that correspond to those presented in Table 16-2, but that are for Federal funds alone with respect to the public and trust funds.

<sup>2</sup> Includes trust fund holdings in other cash assets and changes in the investments of the National Railroad Retirement Investment Trust in non-Federal securities.

<sup>3</sup> Consists of unamortized discount (less premium) on public issues of Treasury notes and bonds (other than zero-coupon bonds).

<sup>4</sup> The statutory debt limit is \$8,965 billion.

### 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, 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.

Foreign holdings of Federal debt are presented in Table 16-6. At the end of 2006, foreign holdings of Treasury debt were \$2,134 billion, which was 44 percent of the total debt held by the public.<sup>12</sup> Foreign central banks owned 66 percent of the Federal debt held by foreign residents; private investors owned nearly all the rest. The percentage held by foreign central banks is up from 63 percent at the end of 2005. All the Federal debt held by foreign residents is denominated in dollars.

<sup>12</sup> 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.

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.<sup>13</sup> 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, large increases in the Federal debt held by foreign residents resumed beginning in 2003. Federal debt held by foreign residents increased by \$203 billion in 2006, and by an average of \$233 billion annually over the last four years. The percentage of Federal debt held

<sup>13</sup> 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.

by foreign residents increased from 34 percent to 44 percent during these four years. The increase in foreign holdings was about 86 percent of total Federal borrowing in 2006 and about 72 percent of total Federal borrowing over the last four 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.

**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 <sup>1</sup>	Percentage foreign	Total <sup>2</sup>	Foreign <sup>1</sup>
1965 .....	260.8	12.3	4.7	3.9	0.3
1970 .....	283.2	14.0	5.0	5.1	3.8
1975 .....	394.7	66.0	16.7	51.0	9.2
1980 .....	711.9	121.7	17.1	71.6	1.4
1985 <sup>3</sup> .....	1,507.3	222.9	14.8	200.3	N/A
1990 <sup>3</sup> .....	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
1994 .....	3,433.1	655.8	19.1	184.7	64.5
1995 <sup>3</sup> .....	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 <sup>3</sup> .....	3,632.4	1,281.4	35.3	-88.7	N/A
2000 <sup>3</sup> .....	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 <sup>3</sup> .....	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	1,798.7	41.9	382.1	344.5
2005 .....	4,592.2	1,930.6	42.0	296.7	131.9
2006 .....	4,829.0	2,133.6	44.2	236.8	202.9

N/A = Not available.

<sup>1</sup> 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.

<sup>2</sup> 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.

<sup>3</sup> Benchmark revisions 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.





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**FEDERAL RECEIPTS AND COLLECTIONS**

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## 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 is 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 next Chapter.

Total receipts in 2008 are estimated to be \$2,662.5 billion, an increase of \$122.4 billion or 4.8 percent relative to 2007. Receipts are projected to grow at an average annual rate of 5.6 percent between 2008 and 2012, rising to \$3,307.3 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 Gross Domestic Product (GDP), receipts are projected to decline from 18.5 percent in 2007 to 18.3 percent in 2008, and to rise to 18.6 percent in 2012.

**Table 17-1. RECEIPTS BY SOURCE—SUMMARY**

(In billions of dollars)

	2006 Actual	Estimate					
		2007	2008	2009	2010	2011	2012
Individual income taxes .....	1,043.9	1,168.8	1,246.6	1,331.1	1,428.3	1,517.3	1,636.6
Corporation income taxes .....	353.9	342.1	314.9	319.8	325.5	340.6	366.6
Social insurance and retirement receipts .....	837.8	873.4	927.2	974.2	1,029.3	1,085.7	1,138.8
(On-budget) .....	(229.4)	(239.2)	(253.1)	(262.8)	(276.0)	(289.9)	(303.4)
(Off-budget) .....	(608.4)	(634.1)	(674.1)	(711.4)	(753.3)	(795.8)	(835.3)
Excise taxes .....	74.0	57.1	68.1	63.1	63.6	68.6	71.3
Estate and gift taxes .....	27.9	25.3	25.7	27.4	21.7	1.7	0.5
Customs duties .....	24.8	26.8	29.2	30.7	32.7	34.3	35.7
Miscellaneous receipts .....	45.0	46.7	50.7	52.0	53.6	55.5	57.8
<b>Total receipts</b> .....	<b>2,407.3</b>	<b>2,540.1</b>	<b>2,662.5</b>	<b>2,798.3</b>	<b>2,954.7</b>	<b>3,103.6</b>	<b>3,307.3</b>
(On-budget) .....	(1,798.9)	(1,906.0)	(1,988.4)	(2,086.9)	(2,201.4)	(2,307.8)	(2,472.0)
(Off-budget) .....	(608.4)	(634.1)	(674.1)	(711.4)	(753.3)	(795.8)	(835.3)
Total receipts as a percentage of GDP .....	18.4	18.5	18.3	18.3	18.3	18.3	18.6

**Table 17-2. EFFECT ON RECEIPTS OF CHANGES IN THE SOCIAL SECURITY TAXABLE EARNINGS BASE**

(In billions of dollars)

	Estimate				
	2008	2009	2010	2011	2012
<b>Social security (OASDI) taxable earnings base increases:</b>					
\$97,500 to \$102,600 on Jan. 1, 2008 .....	2.7	7.0	7.9	8.8	9.7
\$102,600 to \$107,700 on Jan. 1, 2009 .....		2.7	7.0	7.9	8.8
\$107,700 to \$113,100 on Jan. 1, 2010 .....			2.8	7.4	8.3
\$113,100 to \$118,500 on Jan. 1, 2011 .....				2.8	7.5
\$118,500 to \$123,600 on Jan. 1, 2012 .....					2.7

Chart 17-1. Major Provisions of the Tax Code Under the 2001, 2003, 2004, and 2006 Enacted Tax Relief

Provision	2003	2004	2005	2006	2007	2008	2009	2010	2011
<b>Individual Income Tax Rates</b>	Rates reduced to 35, 33, 28, and 25 percent								Rates revert to 39.6, 36, 31, and 28 percent
<b>10 Percent Bracket</b>	Top of bracket increased to \$7,000/\$14,000 for single/joint filers and inflation-indexed								Bracket eliminated, lowest bracket reverts to 15 percent
<b>15 Percent Bracket for Joint Filers</b>	Top of bracket for joint filers increased to 200 percent of top of bracket for single filers								Top of bracket for joint filers reverts to 167 percent of top of bracket for single filers
<b>Standard Deduction for Joint Filers</b>	Standard deduction for joint filers increased to 200 percent of standard deduction for single filers								Standard deduction for joint filers reverts to 167 percent of standard deduction for single filers
<b>Child Credit</b>	Tax credit for each qualifying child under age 17 increased to \$1,000 and refundability extended to families with 1 or 2 children								Tax credit for each qualifying child under age 17 reverts to \$500 and refundability restricted to taxpayers with 3 or more children
<b>Estate Taxes</b>	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 reverts to 60 percent Exempt amount reverts to \$1 million
<b>Small Business Expensing</b>	Deduction increased to \$100,000, reduced by amount qualifying property exceeds \$400,000, and both amounts inflation-indexed Includes software							Deduction reverts to \$25,000, reduced by amount qualifying property exceeds \$200,000 and amounts not inflation-indexed Does not apply to software	

Chart 17–1. Major Provisions of the Tax Code Under the 2001, 2003, 2004, and 2006 Enacted Tax Relief—Continued

Provision	2003	2004	2005	2006	2007	2008	2009	2010	2011
<b>Capital Gains</b>	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 reverts to 10/20 percent (8/18 percent on assets held over 5 years)
<b>Dividends</b>	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
<b>Bonus Depreciation</b>	Bonus depreciation increased to 50 percent of qualified property acquired after 5/5/03		Bonus depreciation expires						
<b>Alternative Minimum Tax</b>	AMT exemption amount increased to \$40,250/\$58,000 for single/joint filers			AMT exemption amount increased to \$42,500/\$62,550 for single /joint filers	AMT exemption amount reverts to \$33,750/\$45,000 for single /joint filers				

## ENACTED LEGISLATION

Several laws were enacted in 2006 that have an effect on governmental receipts. The major legislative changes affecting receipts are described below.

### TAX INCREASE PREVENTION AND RECONCILIATION ACT OF 2005

The Tax Increase Prevention and Reconciliation Act of 2005 (TIPRA), which was signed by President Bush on May 17, 2006, extended previously enacted tax cuts that helped spur investment and economic expansion, resulting in more jobs and higher wages for American workers. The provisions of this Act increased the Alternative Minimum Tax (AMT) exemption amount for 2006; temporarily extended increased expensing limits for small businesses; reduced tax rates on capital gains and dividends; and made other miscellaneous changes to tax law. The major provisions of this Act are described below.

#### Expiring Provisions

**Extend increased expensing for small business.**—Under prior law, business taxpayers were 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 beginning in 2003 through 2007. The maximum amount that could be expensed was reduced by the amount by which the taxpayer's cost of qualifying property exceeded \$400,000. Both the deduction and

annual investment limits were 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 were permitted to make or revoke expensing elections on amended returns without the consent of the Internal Revenue Service (IRS) Commissioner. This Act extended each of these temporary provisions, applicable for qualifying property (including off-the-shelf computer software) placed in service in taxable years beginning in 2008 and 2009.

**Extend reductions in individual income taxes on capital gains and dividends.**—Under prior law, the maximum individual income tax rate on net capital gains and dividends was 15 percent for taxpayers in individual income tax rate brackets above 15 percent and 5 percent (zero in 2008) for lower income taxpayers. This Act extended these reduced rates (15 percent and zero), which were scheduled to expire on December 31, 2008, through December 31, 2010.

**Extend and modify exceptions provided under Subpart F.**—Under the Subpart F rules, certain U.S. shareholders of a controlled foreign corporation (CFC) are subject to U.S. tax currently on certain income earned by the CFC, whether or not such income is distributed to the shareholders. The income subject to current inclusion under the Subpart F rules includes, among other things, "foreign personal holding company

income” and insurance income. Foreign personal holding company income generally includes many types of income derived by a financial service company, such as dividends; interest; royalties; rents; annuities; net gains from the sale of certain property, including securities, commodities and foreign currency; and income from notional principal contracts and securities lending activities. Under prior law, for taxable years beginning before January 1, 2007, certain income derived in the active conduct of a banking, financing, insurance, or similar business was provided an exception from Subpart F. This Act extended the exception for two years, to apply to taxable years beginning before January 1, 2009. This Act also provided an exception from Subpart F for dividends, interest, rents, and royalties received by one CFC from a related CFC to the extent attributable or properly allocable to non-Subpart F income of the payor, effective for taxable years beginning after December 31, 2005 and before January 1, 2009.

### Estimated Tax Payments by Corporations

**Modify the timing of estimated tax payments by corporations.**—Corporations generally are required to pay their income tax liability in quarterly estimated payments. For corporations that keep their accounts on a calendar year basis, these payments are due on or before April 15, June 15, September 15, and December 15 (if these dates fall on a holiday or weekend, payment is due on the next business day). This Act increased the estimated tax payments due in July through September by corporations with assets of at least \$1 billion to: 105 percent of the amount otherwise due in 2006, 106.25 percent of the amount otherwise due in 2012, and 100.75 percent of the amount otherwise due in 2013. For corporations affected by this provision, the next required estimated tax payment is reduced accordingly. This Act also allowed corporations to delay 20.5 percent of the estimated tax payment otherwise due on September 15, 2010 until October 1, 2010, and 27.5 percent of the estimated tax payment otherwise due on September 15, 2011 until October 1, 2011.

### Alternative Minimum Tax (AMT) Relief for Individuals

**Increase and extend AMT relief for individuals.**—A temporary provision of prior law increased the 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. These temporary increases were effective for taxable years beginning after December 31, 2002 and before January 1, 2006. This Act increased the AMT exemption amounts, effective for taxable years beginning after December 31, 2005 and before January 1, 2007, to \$42,500 for single taxpayers, \$62,550 for married taxpayers filing a joint return and surviving spouses, and \$31,275 for married taxpayers filing a separate return and estates and trusts.

Under a temporary provision of prior law, taxpayers were permitted to offset both the regular tax and the AMT with nonrefundable personal tax credits, effective for taxable years beginning before January 1, 2006. This Act extended minimum tax relief for nonrefundable personal tax credits for one year, to apply to taxable year 2006. The extension does not apply to the child credit, the new saver’s credit, the earned income credit (EITC) 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.

### Offsets

**Repeal income limitations on Roth Individual Retirement Account (IRA) conversions.**—Under prior law, taxpayers with adjusted gross income (AGI) of less than \$100,000 were eligible to roll over or convert all or a portion of a traditional IRA to a Roth IRA. Amounts converted were treated as distributions for income tax purposes, but the 10-percent tax on early withdrawals did not apply. This Act repealed the income limitation on conversions from traditional IRAs to Roth IRAs, effective for conversions occurring after December 31, 2009. Unless a taxpayer elects otherwise (or converted amounts are distributed before 2012), none of the amount converted in 2010 will be included in gross income for that year; instead, half of the amount converted will be included in gross income in each year, 2011 and 2012. If converted amounts are distributed before 2012, the amount included in income in the year of the distribution is increased by the amount distributed, and the amount included in income in 2012 (or 2011 and 2012 if the distribution was made in 2010) is the lesser of: (1) half of the amount includible in income as a result of the conversion, and (2) the remaining portion of such amount not already included in income.

**Repeal foreign sales corporation (FSC)/extraterritorial income (ETI) binding contract relief.**—The FSC Repeal and ETI Exclusion Act of 2000 replaced the FSC tax provisions of prior law, which the World Trade Organization (WTO) had found to be a prohibited export subsidy in violation of international tax standards, with an exclusion from U.S. tax for extraterritorial income. Transition rules delayed the repeal of the FSC rules and the effective date of ETI for transactions in the ordinary course of a trade or business if such transactions were pursuant to a binding contract between the taxpayer and an unrelated person and the contract was in effect on September 30, 2000 and at all other times thereafter. The ETI provisions also were declared a prohibited export subsidy by the WTO and were repealed by the American Jobs Creation Act of 2004, effective for transactions after December 31, 2004. Certain transitional tax rules applied to transactions occurring in 2005 and 2006, providing taxpayers with 80 percent and 60 percent, re-

spectively, of the tax benefits that would have been otherwise allowed under the prior law ETI provisions. Moreover, the ETI provisions of prior law remained in effect for transactions in the ordinary course of a trade or business if such transactions were pursuant to a binding contract between the taxpayer and an unrelated person and the contract was in effect on September 17, 2003 and at all times thereafter. Both the FSC and ETI binding contract relief of prior law were repealed under this Act, effective for taxable years beginning after May 17, 2006.

**Impose withholding on certain payments made by government entities.**—This Act imposed withholding on certain payments made by government entities (the Government of the United States, every State, and every political subdivision or instrumentality thereof, including multi-State agencies) to persons providing property or services. The requirement applies regardless of whether the government entity making the payment is the recipient of the property or service. The rate of withholding is three percent and applies to payments made after December 31, 2010. Political subdivisions of States (or any instrumentality thereof) with less than \$100 million of annual expenditures for property or services are exempt from the withholding requirement. In addition, the provision does not apply to: (1) payments made through a public assistance or public welfare program for which eligibility is determined by a needs or income test; (2) payments, such as wages, that were subject to mandatory or voluntary withholding under prior law; (3) payments of interest; (4) payments for real property; (5) payments to tax-exempt entities or foreign governments; (6) intra-governmental payments; (7) payments made pursuant to a classified or confidential contract; and (8) payments to government employees that are not otherwise excludable from the new withholding provision with respect to the employees' services as an employee.

**Modify taxation of citizens living abroad.**—U.S. citizens who earn income in a foreign country may be taxed on that income by the foreign country. Such individuals are allowed a credit against the U.S. income tax imposed on foreign-source income for foreign taxes paid on that income; the amount of the credit generally is limited to the amount of U.S. tax otherwise owed on that income.

A U.S. citizen or resident living abroad may be eligible to exclude from U.S. taxable income certain foreign earned income and foreign housing costs, regardless of whether any foreign tax is paid on the foreign earned income or housing costs. To qualify for these exclusions, the taxpayer must have his or her tax home in a foreign country and must be either: (1) a U.S. citizen who is a bona fide resident of a foreign country or countries for an uninterrupted period that includes an entire taxable year, or (2) a U.S. citizen or resident present in a foreign country or countries for at least 330 full days in any 12-consecutive-month period.

The foreign earned income exclusion generally is available for a qualified individual's non-U.S. source earned income attributable to personal services performed by that individual during the period of foreign residence or presence. Under prior law, the maximum amount of the foreign earned income exclusion was \$80,000 in taxable years 2002 through 2007 and was indexed annually for inflation beginning in taxable year 2008. This Act accelerated the annual indexation of the maximum amount of the foreign earned income exclusion by two years, increasing the limitation for taxable year 2006 to \$82,400.

The housing cost exclusion (or deduction for purposes of computing AGI, if the otherwise excludable housing costs are not paid or reimbursed by a taxpayer's employer) is equal to the excess of a taxpayer's "housing expenses" over a base housing amount. "Housing expenses" are the reasonable expenses paid or incurred during the taxable year for housing in a foreign country for the taxpayer, and, if they live with the taxpayer, the taxpayer's spouse and dependents. Housing expenses include costs attributable to housing, such as utilities and insurance, but do not include items that are separately deductible, such as mortgage interest and real estate taxes. If the taxpayer maintains a second household outside the United States for a spouse or dependents who do not reside with the taxpayer because of dangerous, unhealthful, or otherwise adverse living conditions, the housing expenses of the second household also are eligible for exclusion. Under prior law, the base housing amount above which costs were eligible for exclusion in a taxable year was 16 percent of the annual salary (computed on a daily basis) of a GS-14 step 1 Federal employee, multiplied by the number of days of foreign residence or presence in the taxable year. This Act modified the base housing amount used in calculating the foreign housing cost exclusion, effective for taxable years beginning after December 31, 2005, changing it to 16 percent of the maximum amount (computed on a daily basis) of the foreign earned income exclusion, multiplied by the number of days of foreign residence or presence in the taxable year. Reasonable housing expenses in excess of the base housing amount may still be excluded from gross income (or, if paid by the taxpayer, deductible in computing AGI), but the amount of the exclusion is limited to 30 percent of the taxpayer's foreign earned income exclusion. Under this Act, the Secretary of the Treasury has authority to adjust this 30-percent limitation upwards or downwards, based on geographic differences in housing costs relative to housing costs in the United States.

As provided under prior law, the combined foreign earned income exclusion and housing cost exclusion (including the amount deductible in computing AGI) may not exceed the taxpayer's total foreign earned income for the taxable year. Similarly, the taxpayer's foreign tax credit must be reduced by the amount of the credit attributable to excluded income.

Under prior law, a taxpayer eligible for the foreign earned income and housing cost exclusions was subject to tax on income in excess of the exclusion amounts (after deductions), starting in the lowest tax rate bracket. Under this Act, effective for taxable years beginning after December 31, 2005, a taxpayer eligible for the foreign earned income and housing exclusions is subject to tax on income in excess of the exclusion amounts at the income tax rates that would have been applicable had the individual not elected to take the exclusions.

**Require partial payment with submission of offers-in-compromise.**—Offers-in-compromise are offers to the IRS by a taxpayer to settle outstanding tax liability for less than the full amount due, generally based on doubt as to liability for, or collectibility of, the tax. There are two general categories of offers-in-compromise: (1) lump-sum offers, in which the taxpayer proposes to make one lump-sum payment of a specified dollar amount in settlement of the outstanding tax liability, and (2) periodic-payment offers, in which the taxpayer proposes to make a series of payments over time in settlement of the outstanding tax liability. The IRS imposes a user fee of \$150 on most offers-in-compromise, payable upon submission of the offer to the IRS. Enforcement action generally is suspended during the period that the IRS evaluates an offer. Under prior law, taxpayers were permitted (but not required) to make a deposit with their offer; if the offer was rejected, the deposit generally was returned to the taxpayer. This Act made the following changes, effective with respect to offers-in-compromise submitted to the IRS on and after July 16, 2006: (1) Taxpayers making lump-sum offers (offers to pay in five or fewer installments) are required to make a down payment of 20 percent of the amount of the offer upon submission of the offer to the IRS. (2) Taxpayers making periodic-payment offers are required to comply with the payment schedule proposed in the offer while the offer is being considered. (3) Offers submitted to the IRS that do not comply with these payment requirements are returned to the taxpayer as unprocessable and immediate enforcement action is permitted. (4) The \$150 user fee is applied to the taxpayer's outstanding tax liability. (5) An offer-in-compromise is deemed accepted if the IRS does not make a decision with respect to the offer within two years from the date the offer was submitted. (6) The Secretary of the Treasury is authorized to issue regulations providing exceptions to the partial payment requirements in the case of offers from certain low-income taxpayers and offers based on doubt as to liability.

**Modify 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. Under prior law, G&G costs paid or incurred in taxable years beginning after Au-

gust 8, 2005, in connection with oil and gas exploration in the United States, could be amortized over two years. This Act increased the amortization period to five years for G&G costs paid or incurred by certain major integrated oil companies after May 17, 2006. This five-year amortization rule applies only to integrated oil companies that have an average daily worldwide production of crude oil of at least 500,000 barrels for the taxable year, have gross receipts in excess of \$1 billion in the last taxable year ending during calendar year 2005, and either are a crude oil refiner or have an ownership interest in a crude oil refiner of 15 percent or more.

**Modify taxation of unearned income of minors.**—An unmarried individual eligible to be claimed as a dependent on another taxpayer's individual income tax return generally must file an individual income tax return if he or she has: (1) earned income only over \$5,150 (for 2006); (2) unearned income only over the minimum standard deduction amount for dependents (\$850 in 2006); or (3) both earned income and unearned income totaling more than the smaller of (a) \$5,150 (for 2006) or (b) the larger of (i) \$850 (for 2006) or (ii) earned income plus \$300. Under prior law, unearned income of a child was taxed under special rules if: (1) the child had not reached the age of 14 by the close of the taxable year, (2) the child's unearned income (income other than wages, salaries, professional fees, or other amounts received as compensation for personal services actually rendered) was more than \$1,700 (for 2006), and (3) the child was required to file a return for the year. These special rules (referred to as the "kiddie tax") applied if the child could have been claimed as a dependent on the parent's return, regardless of whether the parent actually claimed the child as a dependent. Under the kiddie tax, the child's net unearned income over \$1,700 (for 2006) was taxed at the parent's tax rate if that rate was higher than the child's rate. The remainder of a child's taxable income was taxed at the child's tax rate, regardless of whether the kiddie tax applied. Effective for taxable years beginning after December 31, 2005, this Act increased the age to which the kiddie tax applies from under 14 years of age to under 18 years of age.

**Provide other offsets.**—Other offsets provided in this Act included: (1) application of earnings stripping rules to partners that are C corporations, (2) amendment of information reporting requirements to include interest paid on tax-exempt bonds, (3) modification of the scope of the application of the Foreign Investment in Real Property Tax Act of 1980 regime, (4) denial of tax-free treatment to certain corporate spin-off transactions, (5) imposition of new requirements on pooled financing bonds, (6) clarification of the domestic manufacturing deduction wage limitation, and (7) imposition of penalties on certain exempt entities for participation in prohibited tax shelter transactions as accommodation parties.



### Other Provisions

**Provide other changes.**—Other changes provided in this Act included: (1) modification of the tax treatment of income earned by certain environmental cleanup funds, (2) modification of the rules relating to taxation of distributions of stock and securities of a controlled corporation, (3) expansion of eligibility for the qualified veterans' mortgage bond program, (4) treatment of the sale or exchange of certain self-created musical works as capital gains, (5) modification of the vessel tonnage tax, (6) extension of the exemption for a portion of the Permanent University Fund from the tax-exempt bond arbitrage rules, (7) election of five-year amortization for the costs of creating or acquiring a musical composition, (8) acceleration of the increased capital expenditure limitation on the issuance of qualified small issue tax-exempt bonds to apply to bonds issued after December 31, 2006, and (9) modification of the tax treatment of loans to qualified continuing care facilities.

### PENSION PROTECTION ACT OF 2006

The Pension Protection Act of 2006, which was signed by President Bush on August 17, 2006, was the most sweeping reform of America's pension system enacted in 30 years. The provisions of this Act strengthened the private retirement system by making it more difficult for employers to underfund their pension plans and by preventing employers with underfunded plans from making promises to their employees that they cannot keep. Provisions of this Act also provided more incentives to individuals to save for retirement, modified tax provisions related to spending for health care, temporarily suspended certain customs duties, provided incentives for certain charitable contributions, and modified certain rules relating to activities of tax-exempt organizations. The major provisions of this Act that affect receipts are described below.

#### Pension Funding Rules

**Reform funding rules for single-employer defined-benefit pension plans.**—Under prior law, defined-benefit pension plans were 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 excluded such contributions from gross income and allowed 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 were determined under a series of complex rules and measures of assets and liability, many of which were manipulable and none of which entailed the use of an accurate measure of the plan's assets and its true liabilities. This Act replaced the funding rules of prior law, effective for plan years beginning after December 31, 2007, with a minimum funding requirement of 100 percent of plan liabilities,

phased in over four years, as follows: 92 percent in 2008, 94 percent in 2009, 96 percent in 2010, and 100 percent in 2011 and subsequent years. Other funding rules provided in this Act: (1) changed the calculation of the value of credit balances and restricted the use of credit balances in lieu of cash to fund required contributions; (2) changed the method of calculating liabilities for plans considered to be at risk; (3) reduced the time period over which asset values can be averaged to two years, and limited averaged asset values to no less than 90 percent and to no more than 110 percent of current fair market value; (4) required amortization of unfunded liabilities over seven years, in most cases; (5) updated the mortality table used to project future benefits; (6) allowed plan sponsors to deduct from taxable income contributions of up to 150 percent of plan liability; and (7) modified the interest rate used to calculate pension liability, requiring the use of a yield curve based on 24-month averages of the rates on corporate bonds of relevant maturities in the top three rating categories (AAA, AA and A), phased in at 33⅓ percent in 2008, 66⅔ percent in 2009 and 100 percent beginning in 2010.

**Reform funding rules for multiemployer defined-benefit plans.**—Multiemployer plans are subject to the same general funding rules as the pre-2006 rules for single-employer plans, except that different rules apply in some cases. This Act modified the funding of multiemployer plans by: (1) providing additional funding rules for certain plans that are in endangered or critical status; and (2) allowing plan sponsors to deduct from taxable income contributions of up to 140 percent of plan liability. These changes were effective for plan years beginning after 2007; however, the additional funding rules for plans in endangered or critical status do not apply to plan years beginning after December 31, 2014.

#### Other Pension Provisions

**Encourage automatic enrollment in pension plans.**—Under current law, most defined-contribution plans may include a qualified cash or deferred arrangement under which employees may elect to receive cash or to have contributions made to the plan by the employer on behalf of the employee in lieu of receiving cash. Contributions made to the plan at the election of the employee are referred to as "elective deferrals." Such a plan may be designed so that the employee will receive cash unless an affirmative election to make contributions is made. Alternatively, a plan may provide that elective contributions are made at a specified rate unless the employee elects otherwise; such a plan is sometimes referred to as an "automatic enrollment" plan. In either case, the employee must have an opportunity to elect to receive cash in lieu of contributions.

This Act made changes to address employers' concerns about implementing automatic enrollment plans and to provide incentives for automatic enrollment, generally effective for plan years beginning after 2007. The

changes provided in the Act: (1) exempted such plans from State payroll withholding laws; (2) provided fiduciary relief for investment of participant account balances in certain default investments; (3) provided a 90-day period from the initial payroll reduction during which participants are allowed to opt out of automatic enrollment and receive a penalty-free return of their automatic elective contributions; and (4) provided that plans with “a qualified automatic enrollment feature” satisfy the nondiscrimination rules regarding elective deferrals and employer matching contributions, and are not subject to the top-heavy rules.

***Allow certain small employers to establish combined defined-benefit plans and qualified cash or deferred arrangements.***—Under prior law, a defined-benefit plan could not be combined with a qualified cash or deferred arrangement (Section 401(k) plan); they had to be structured as two separate plans. This Act allowed small employers to establish combined defined-benefit and 401(k) plans, effective for plan years beginning after December 31, 2009. A small employer is an employer with an average of at least two and no more than 500 employees on business days during the preceding calendar year and at least two employees on the first day of the plan year. The assets of the combined plan must be held in a single trust and they must be clearly identified and allocated to the defined-benefit plan and the 401(k) plan to the extent necessary for the separate application of the Internal Revenue Code and ERISA; in addition, the combined plan must meet certain benefit, contribution, vesting, and nondiscrimination requirements.

***Make other miscellaneous changes affecting pension plans.***—Other changes in pension plans that affect receipts: (1) permitted workers in publicly held companies to divest themselves of company stock attributable to employer contributions after three years of service and prohibited employers from requiring workers to invest their own retirement savings in company stock; (2) improved portability of retirement savings, such as allowing direct rollovers from retirement plans to Roth IRAs and faster vesting of employer non-elective contributions; (3) gave taxpayers the option to deposit part of their individual income tax refund directly into an IRA; and (4) allowed members of the National Guard and reservists called to active duty to withdraw money from their IRA or pension without penalty and to repay the money within two years.

### Expiring Provisions

***Extend permanently IRA maximum contribution limits and index income limitations on IRA contributions.***—The maximum annual contribution that can be made to a traditional or Roth IRA by or on behalf of an individual varies depending on the particular circumstances, including the individual’s income. However, under prior law, the maximum annual contribution that could be made to all of an Individual’s

IRAs was the lesser of: (1) the individual’s compensation or (2) \$4,000 for taxable years 2005 through 2007, and \$5,000 for taxable year 2008, indexed thereafter in increments of \$500. In the case of a married couple, contributions could be made up to the dollar limit for each spouse if the combined compensation of the spouses was at least equal to the contributed amount. Individuals who attained age 50 before the end of a taxable year were allowed to make additional “catch-up” contributions. For those individuals, the otherwise maximum contribution limit was increased by \$1,000 for taxable years 2006 through 2010. These contribution limits, which had been scheduled to expire after December 31, 2010, were extended permanently under this Act.

An individual may make nondeductible contributions to a traditional IRA up to the IRA contribution limits specified above (to the extent the taxpayer cannot or does not make deductible contributions). An individual may make deductible contributions to a traditional IRA up to the IRA contribution limits specified above, if neither the individual nor the individual’s spouse is an active participant in an employer-sponsored retirement plan. If an individual (or the individual’s spouse) is an active participant in an employer-sponsored retirement plan, the deduction is phased out for taxpayers with AGI above certain levels. Under prior law, the AGI phase-out ranges were: (1) \$50,000 to \$60,000 for single taxpayers; (2) \$80,000 to \$100,000 for married taxpayers filing a joint return for 2007 and subsequent years; and (3) \$0 to \$10,000 for married taxpayers filing a separate return. If an individual was not an active participant in an employer-sponsored retirement plan, but the individual’s spouse was an active participant in such a plan, the deduction was phased out for taxpayers with AGI between \$150,000 and \$160,000. An individual may make nondeductible contributions to a Roth IRA subject to the IRA contribution limits specified above. However, the maximum annual contribution is phased out for taxpayers with AGI over certain levels. Under prior law, the AGI phase-out ranges were: (1) \$95,000 to \$110,000 for single taxpayers; (2) \$150,000 to \$160,000 for married taxpayers filing a joint return; and (3) \$0 to \$10,000 for married taxpayers filing a separate return. Under this Act, the income thresholds that determine eligibility to make IRA contributions are indexed for inflation in increments of \$1,000 beginning in 2007.

***Extend permanently maximum contribution and benefit limits under qualified pension plans.***—Limits on contributions and benefits under qualified pension plans are based on the type of plan. Under prior law, annual contributions to a defined-contribution plan with respect to each plan participant were limited to the lesser of 100 percent of compensation or \$40,000 (adjusted annually for inflation in \$1,000 increments after 2002). The maximum annual benefit payable under a defined-benefit plan was generally the lesser of 100 percent of average compensation or \$160,000 (adjusted annually for inflation for plans ending after

December 31, 2002, in increments of \$1,000). The annual compensation of each participant that could be taken into account for purposes of determining contributions and benefits under a plan generally was limited to \$200,000 in 2002 (indexed annually thereafter in \$5,000 increments). The dollar limit on annual elective deferrals under section 401(k) plans, section 403(b) annuities and salary reduction SEPs was \$15,000 in 2006, indexed annually thereafter in \$500 increments. The dollar limit on annual elective deferrals to a SIMPLE plan was \$10,000 in 2005 (adjusted for inflation in increments of \$500 after 2006). The dollar limit on contributions to an eligible section 457 plan was the lesser of 100 percent of includable compensation or \$15,000 in 2006, indexed annually thereafter in increments of \$500. Individuals who attained age 50 before the end of a taxable year were allowed to make “catch-up” contributions to a 401(k) plan, section 403(b) annuity, SEP or SIMPLE plan, or section 457 plan. The amount of catch-up contributions permitted was the lesser of: (1) the applicable dollar amount or (2) the participant’s compensation for the year after reduction by any other elective deferrals of the participant for the year. The applicable dollar amount under a 401(k) plan, section 403(b) annuity, SEP or section 457 plan was \$5,000 for 2006, indexed annually thereafter in increments of \$500. The applicable dollar amount under a SIMPLE plan was \$2,500 in 2006, indexed annually thereafter in increments of \$500. These contribution and benefit limits, which were scheduled to expire after December 31, 2010, were extended permanently under this Act.

***Extend permanently the ability to make tax-free distributions from qualified tuition programs (section 529 of the Internal Revenue Code).***—Qualified State tuition programs generally take two forms—prepaid tuition plans and savings plans. Under a prepaid tuition plan, an individual may purchase tuition credits or certificates on behalf of a designated beneficiary, which entitle the beneficiary to the waiver or payment of qualified higher education expenses at participating educational institutions. Under a savings plan, an individual may make contributions to an account established for the purpose of meeting the qualified higher education expenses of a designated beneficiary. Private educational institutions are also allowed to establish qualified prepaid tuition plans (but not savings plans), provided the institution is eligible to participate in Federal financial aid programs under Title IV of the Higher Education Act of 1965. Earnings in a qualified savings program accumulate tax free. Under current law, if a distribution is used to pay qualified higher education expenses, the distribution is tax free. Qualified expenses include: tuition and fees; certain expenses for room and board; certain expenses for books, supplies and equipment; and expenses for a special needs beneficiary that are necessary in connection with enrollment or attendance at an eligible education institution. This Act permanently extended the preferred tax treatment of the distributions, which was scheduled to expire with

respect to withdrawals after December 31, 2010. This Act also granted broad authority to the Secretary of the Treasury to issue regulations to carry out the purposes of section 529 and to prevent abuse of those purposes.

***Extend permanently the nonrefundable tax credit (saver’s credit) for certain elective deferrals and IRA contributions.***—Under prior law, effective for taxable years beginning after December 31, 2001 and before January 1, 2007, a nonrefundable tax credit was provided for up to \$2,000 in contributions made by eligible taxpayers to a qualified plan or to a traditional or Roth IRA. The credit, which was in addition to any deduction or exclusion that would otherwise apply with respect to the contribution, was available to single taxpayers with AGI less than or equal to \$25,000 (\$37,500 for heads of household and \$50,000 for married taxpayers filing a joint return). The credit was available to individuals who were 18 years of age or older (other than individuals who were full-time students or claimed as a dependent on another taxpayer’s return) and was offset against both the regular and alternative minimum tax. The credit rate was 50 percent for single taxpayers with AGI less than or equal to \$15,000 (\$30,000 for married taxpayers filing a joint return and \$22,500 for heads of household), 20 percent for single taxpayers with AGI between \$15,000 and \$16,250 (between \$30,000 and \$32,500 for married taxpayers filing a joint return and between \$22,500 and \$24,375 for heads of household), and 10 percent for single taxpayers with AGI between \$16,250 and \$25,000 (between \$32,500 and \$50,000 for married taxpayers filing a joint return and between \$24,375 and \$37,500 for heads of household). The saver’s credit was extended permanently under this Act. In addition, this Act provided for annual indexing of the income limits applicable to the credit in increments of \$500 beginning in 2007.

### Health and Medical Benefits

***Modify tax treatment of annuity and life insurance contracts with a long-term care insurance feature.***—Under prior law, annuity contracts were not allowed to have a qualified long-term care insurance feature; however, long-term care insurance could be provided by a rider on or as a part of a life insurance contract. This Act allowed qualified long-term care insurance to be provided by a rider on or as a part of an annuity contract and provided special tax treatment for the long-term care component of a life insurance or annuity contract. Under this Act: (1) payments for a qualified long-term care insurance contract, which is a rider on or is part of a life insurance contract or annuity contract, that are charged against the cash value of the annuity contract or the cash surrender value of the life insurance contract are not includable in income and the investment in the contract is reduced (but not below zero) by the charge; (2) the rules for tax-free exchanges of certain insurance contracts are expanded to include exchanges of a life insurance con-

tract, an endowment contract, an annuity contract, or a qualified long-term care insurance contract for a qualified long-term care insurance contract; and (3) except as otherwise provided in regulations, the portion of an annuity or life insurance contract providing long-term care insurance coverage is treated as a separate contract for Federal tax purposes. These, and other rules concerning the taxation of long-term care insurance provided as a rider on or as part of an annuity or life insurance contract generally will be effective for taxable years beginning after December 31, 2009 for contracts issued after December 31, 1996.

**Permit tax-free distributions from governmental retirement plans for premiums for health and long-term care insurance for public safety officers.**—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 IRA generally is included in the taxpayer's gross income in the year of distribution, except to the extent the amount received constitutes a return of after-tax contributions or a qualified distribution from a Roth IRA. This Act provided an annual exclusion from gross income for up to \$3,000 in otherwise taxable distributions from an eligible retirement plan of a qualified public safety officer for the payment of qualified health insurance premiums made directly to the insurer. Eligible retired public safety officers are individuals who, by reason of disability or attainment of normal retirement age, are separated from service with the employer who maintains the eligible retirement plan from which pension benefits are received. Qualified health insurance premiums include premiums for accident or health insurance or qualified long-term care insurance contracts covering the taxpayer and the taxpayer's spouse and dependents. Amounts excluded from income are not taken into account in determining the itemized deduction for medical expenses or the deduction for health insurance of self-employed individuals. The provision is effective for distributions in taxable years beginning after December 31, 2006.

### **Charitable Contributions and Tax-Exempt Organizations**

**Permit tax-free withdrawals from IRAs for charitable contributions.**—Eligible individuals may make deductible or non-deductible contributions to a traditional IRA and nondeductible contributions to a Roth IRA. Pre-tax contributions and earnings in a traditional IRA are included in income when withdrawn. Qualified withdrawals from a Roth IRA are excluded from gross income; withdrawals that are not qualified are included in gross income to the extent attributable to earnings. This Act provided an exclusion from gross income for otherwise taxable distributions from a traditional or a Roth IRA made directly to a qualified charitable organization. The exclusion may not exceed \$100,000 per taxpayer per taxable year, is applicable only to distribu-

tions made on or after the date the IRA owner attains age 70½, and is effective for distributions made in taxable years beginning after December 31, 2005 and before January 1, 2008. The exclusion applies only if a charitable contribution deduction for the entire distribution would otherwise be allowable under current law, determined without regard to the percentage-of-AGI limitation. No charitable deduction is allowed with respect to any amount excludable from income under this provision.

**Expand 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, or, if less, the fair market value of 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.

The Katrina Emergency Tax Relief Act of 2005 expanded the enhanced deduction to apply to qualified contributions of food inventory made after August 27, 2005 and before January 1, 2006 by all taxpayers (not just C corporations) engaged in a trade or business. This Act extended the enhanced charitable deduction for contributions of food inventory provided under the Katrina Emergency Tax Relief Act of 2005 to apply to contributions made after December 31, 2005 and before January 1, 2008. The donated food must meet certain quality and labeling standards, and, for taxpayers other than C corporations, the total deduction for donated food inventory may not exceed 10 percent of the taxpayer's net income from the related trade or business.

**Modify basis adjustment to stock of S corporations contributing appreciated property.**—Each shareholder of an S corporation must take into account his or her pro rata share of a charitable contribution by the S corporation in determining his or her income tax liability. For donations of property, this generally is the pro rata share of the property's fair market value. Under prior law, the shareholder's basis in the stock of the company was reduced by the amount of the charitable contribution that flowed through to the shareholder. Under this Act, effective for charitable contributions made by an S corporation in taxable years beginning after December 31, 2005 and before January 1,

2008, shareholders are allowed to adjust their basis in the stock of the company by their pro rata share of the adjusted basis of the contributed property instead of by their pro rata share of the market value of the contributed property.

**Make other changes affecting charitable contributions and tax-exempt organizations.**—Other incentives for charitable contributions or modifications in the tax treatment of tax-exempt organizations provided in this Act included: (1) extension of the enhanced deduction for contributions of books to public schools for two years; (2) modification of the tax treatment of certain payments to controlling exempt organizations; (3) modification of the deduction for qualified conservation contributions; (4) modification of the deduction for charitable contributions of clothing and household items that are not in good condition and for items of minimal monetary value; (5) expansion of the definition of gross investment income of private foundations; (6) increases in penalty excise taxes applicable to certain activities of charities, social welfare organizations, and private foundations; (7) modification of recordkeeping and substantiation requirements; and (8) provision of new rules governing donor advised funds and supporting organizations.

#### **TAX RELIEF AND HEALTH CARE ACT OF 2006**

The Tax Relief and Health Care Act of 2006, which was signed by President Bush on December 20, 2006, extended a number of expired or expiring tax provisions, modified health savings accounts, modified various trade measures, and made a number of other changes to tax law. This Act also authorized drilling for oil in the Gulf of Mexico, rolled back a cut in Medicare physician payments, and amended the Surface Mining Control and Reclamation Act. The major provisions of this Act that affect receipts are described below.

#### **Expiring Provisions**

**Extend deduction for qualified tuition and related expenses.**—An above-the-line deduction of up to \$4,000 is provided for qualified higher education expenses paid by a qualified taxpayer during the taxable year. For a given taxable year, the deduction may not be claimed if an education tax credit is claimed for the same student. In addition, the deduction may not be claimed for amounts taken into account in determining the amount excludable from income due to a distribution from a Coverdell education IRA or the amount of interest excludable from income with respect to education savings bonds. A taxpayer may not claim a deduction for the amount of a distribution from a qualified tuition plan that is excludable from income; however, the deduction may be claimed for the amount of a distribution from a qualified tuition plan that is not attributable to earnings. This Act extended the deduction, which had expired with respect to expenses incurred in taxable years beginning after December 31,

2005, to apply to expenses incurred in taxable years beginning before January 1, 2008.

**Extend and modify the new markets tax credit.**—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 extended the new markets tax credit through 2008 and permitted up to \$3.5 billion in qualified equity investment for that calendar year. This Act also required the Secretary of the Treasury to prescribe regulations to ensure that non-metropolitan counties receive a proportional allocation of qualified equity investments.

**Extend optional deduction for State and local general sales taxes.**—Under prior law, effective for taxable years beginning after December 31, 2003 and before January 1, 2006, a taxpayer was allowed to elect to take an itemized deduction for State and local general sales taxes in lieu of the itemized deduction for State and local income taxes. This Act extended this deduction for two years, effective for taxable years beginning before January 1, 2008.

**Extend and modify the research and experimentation (R&E) tax credit.**—The 20-percent tax credit for qualified research and experimentation expenditures above a base amount and the alternative incremental credit expired with respect to expenditures incurred after December 31, 2005. This Act: (1) extended the research credit for two years, to apply to expenditures incurred before January 1, 2008; (2) extended the alternative incremental credit for one year, without modification, to apply to expenditures incurred before January 1, 2007; and (3) modified the alternative incremental credit and established an alternative simplified credit, to apply to expenditures incurred after December 31, 2006 and before January 1, 2008.

**Extend and modify the work opportunity tax credit and the welfare-to-work tax credit.**—The work opportunity tax credit (WOTC) 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 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 per-

cent 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 Act extended both the WOTC and the welfare-to-work tax credit for one year without modification, effective for wages paid to qualified individuals who began work for the employer after December 31, 2005 and before January 1, 2007. For wages paid to individuals who begin work for the employer after December 31, 2006 and before January 1, 2008, this Act combined and modified the two credits. Modifications included: (1) use of the WOTC definition of wages; (2) repeal of the requirement that a qualified ex-felon be certified as a member of an economically disadvantaged family; (3) expansion of eligibility by increasing the age ceiling for the food stamp recipient category; and (4) extension of the paperwork filing deadline from 21 days to 28 days.

***Extend treatment of combat pay for purposes of computing the EITC.***—This Act extended for one year, through December 31, 2007, 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.

***Extend and modify authority to issue Qualified Zone Academy Bonds.***—State and local governments are allowed 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 must be used for teacher training, purchases of equipment, curriculum development, or rehabilitation and repairs at certain public school facilities. Under prior law, a nationwide total of \$400 million of qualified zone academy bonds were authorized to be issued in each of calendar years 1998 through 2005 and unused authority could be carried forward for up to two years. This Act authorized the issuance of an additional \$400 million of qualified zone academy bonds in each of calendar years 2006 and 2007. This Act also: (1) extended the arbitrage requirements that apply to interest-bearing tax-exempt bonds to qualified zone academy bonds, (2) imposed new spending requirements on the issuers of these bonds, and (3) imposed new reporting requirements on the issuers of these bonds.

***Extend the above-the-line deduction for qualified out-of-pocket classroom expenses.***—Taxpayers who itemize deductions (do not use the standard deduction) and incur unreimbursed, job-related expenses may deduct those expenses to the extent that when combined with other miscellaneous itemized deductions they exceed two percent of AGI. Through 2005, certain teachers and other elementary and secondary school professionals could deduct up to \$250 in annual qualified out-of-pocket classroom expenses above-the-line. Ex-

penses claimed as an above-the-line deduction could not be claimed as an itemized deduction. This Act extended this above-the-line deduction to apply to expenses incurred before January 1, 2008.

***Extend and expand expensing of brownfields remediation costs.***—Taxpayers may elect to treat certain environmental remediation expenditures that would otherwise be chargeable to a capital account as deductible in the year paid or incurred. This Act extended this provision, making it available for environmental remediation expenditures paid or incurred after December 31, 2005 and before January 1, 2008. In addition, this Act expanded the provision to apply to expenditures paid or incurred to abate contamination at sites contaminated by petroleum products, which include crude oil, crude oil condensates and natural gasoline.

***Extend tax incentives for the District of Columbia (DC).***—A one-time, nonrefundable \$5,000 tax credit is available to purchasers of a principal residence in DC who have not owned a residence in DC during the year preceding the purchase. The credit phases out for taxpayers with modified AGI between \$70,000 and \$90,000 (\$110,000 and \$130,000 for joint returns). This Act extended the credit for two years, making it available with respect to purchases after December 31, 2005 and before January 1, 2008.

The DC Enterprise Zone includes the DC Enterprise Community and DC census tracts with a poverty rate of at least 20 percent. Businesses in the zone are eligible for: (1) A wage credit equal to 20 percent of the first \$15,000 in annual wages paid to qualified employees who reside within DC; (2) \$35,000 in increased section 179 expensing; and (3) in certain circumstances, tax-exempt bond financing. In addition, a capital gains exclusion is allowed for certain investments held more than five years and made within the DC Enterprise Zone, or within any DC census tract with a poverty rate of at least 10 percent. This Act extended the DC Enterprise Zone incentives for two years, through December 31, 2007.

***Extend tax incentives for employment and investment on Indian reservations.***—This Act extended for two years, through December 31, 2007, the employment tax credit for qualified workers employed on an Indian reservation and the accelerated depreciation rules for qualified property used in the active conduct of a trade or business within an Indian reservation. The employment tax credit is not available for employees involved in certain gaming activities or who work in a building that houses certain gaming activities. Similarly, property used to conduct or house certain gaming activities is not eligible for the accelerated depreciation recovery periods.

***Extend modified recovery period for qualified leasehold improvements and qualified restaurant property.***—A taxpayer generally must capitalize the cost of property used in a trade or business and recover

such cost over time through annual deductions for depreciation or amortization. Tangible property generally is depreciated under the modified accelerated cost recovery system (MACRS). Under this system, depreciation is determined by applying specified recovery periods, placed-in-service conventions, and depreciation methods to the cost of various types of depreciable property. Depreciation allowances for improvements made on leased property are determined under MACRS, even if the recovery period assigned to the property is longer than the term of the lease. Under prior law, the recovery period for qualified leasehold improvement property and qualified restaurant property was temporarily reduced from 39 years to 15 years, effective for such property placed in service after October 22, 2004 and before January 1, 2006. This Act extended the 15-year recovery period applicable to qualified leasehold improvement property and qualified restaurant property, effective for such property placed in service before January 1, 2008.

***Extend tax on failure to comply with mental health parity requirements applicable to group health plans.***—Group health plans that provide both mental health benefits and medical and surgical benefits cannot impose aggregate lifetime or annual dollar limits on mental health benefits that are not imposed on substantially all medical and surgical benefits. An excise tax of \$100 per day for each individual affected (during the period of noncompliance) is imposed on an employer sponsoring a group plan that fails to meet these requirements. For a given taxable year, the tax is limited to the lesser of 10 percent of the employer's group health insurance expenses for the prior taxable year or \$500,000. This Act extended the mental health parity requirements and excise tax for failure to comply with these requirements, which had been scheduled to expire with respect to benefits furnished after December 31, 2006, through December 31, 2007.

***Extend deduction for corporate donations of computer technology.***—The charitable contribution deduction that may be claimed by corporations for donations of inventory property generally is limited to the lesser of fair market value or the corporation's basis in the property. However, corporations are provided enhanced deductions, not subject to this limitation, for: (1) a "qualified research contribution", or (2) a "qualified computer contribution." The enhanced deduction is equal to the lesser of: (1) basis plus one-half of the item's fair market value in excess of basis, or (2) two times basis. This Act extended the enhanced deduction for a qualified computer contribution, which expired with respect to donations made after December 31, 2005, to apply to donations made before January 1, 2008. (The enhanced deduction for "qualified research contributions" does not expire.) In addition, this Act expanded the definition of property eligible for either the enhanced deduction relating to research equipment or computers to property assembled by the taxpayer;

under prior law the deduction was restricted to property constructed by the taxpayer.

***Extend Archer Medical Savings Accounts (Archer MSAs).***—Self-employed individuals and employees of small firms are allowed to establish Archer MSAs; the number of accounts is capped at 750,000. In addition to other requirements: (1) individuals who establish Archer MSAs must be covered by a high-deductible health plan (and no other plan) with a deductible of at least \$1,750 but not greater than \$2,650 for policies covering a single person and a deductible of at least \$3,500 but not greater than \$5,250 in all other cases (these amounts are indexed annually for inflation); (2) tax-preferred contributions are limited to 65 percent of the deductible for single policies and 75 percent of the deductible for other policies; and (3) either an individual or an employer, but not both, may make a tax-preferred contribution to an Archer MSA for a particular year. Under prior law, no new contributions could be made to an Archer MSA after December 31, 2005, except for the following: (1) those made by or on behalf of individuals who previously had Archer MSA contributions and (2) those made by individuals employed by a participating employer. This Act extended the Archer MSA program for two years, through December 31, 2007.

***Extend suspension of net income limitation on percentage depletion for marginal oil and gas wells.***—Taxpayers are allowed to recover their investment in oil and gas wells through depletion deductions. For certain properties, deductions may be determined using the percentage of depletion method; however, in any year, the amount deducted generally may not exceed 100 percent of the net income from the property. Under prior law, for taxable years beginning after December 31, 1997 and before January 1, 2006, domestic oil and gas production from "marginal" properties was exempt from the 100-percent-of-net-income limitation. This Act extended the exemption to apply to taxable years beginning after December 31, 2005 and before January 1, 2008.

***Extend economic development credit for American Samoa.***—Certain domestic corporations with business operations in the U.S. possessions are eligible for the possession tax credit, which offsets the U.S. tax imposed on certain income related to operations in the U.S. possessions (including, among other places, American Samoa). The possession tax credit is available only to a corporation that qualifies as an existing credit claimant; the determination of whether a corporation is an existing credit claimant is made separately for each possession. The credit is computed separately for each possession with respect to which the corporation is an existing claimant and the credit is subject to either an economic activity-based limitation or an income-based limit. Under prior law, the possession tax credit was repealed for new claimants for taxable years beginning after December 31, 1995, and was phased

out for existing credit claimants for taxable years beginning after December 31, 1995 and before December 31, 2006. This Act extended and modified the credit with respect to American Samoa. Under the provision, a domestic corporation that was an existing credit claimant with respect to American Samoa and that elected the application of the possession tax credit for its last taxable year beginning before January 1, 2006 is allowed to claim a possession tax credit based on the economic activity-based limitation rules for the first two taxable years beginning after December 31, 2005 and before January 1, 2008.

***Extend placed-in-service deadline for certain Gulf Opportunity Zone 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 the Gulf Opportunity Zone Act of 2005, qualifying Gulf Opportunity Zone (GO Zone) property was provided an additional first-year depreciation deduction equal to 50 percent of the adjusted basis of the property. In order to qualify, property generally had to be tangible property with a recovery period of 20 years or less and included: (1) certain computer software; (2) water utility property; (3) leasehold improvement property; (4) non-residential real property; and (5) residential rental property. In addition: (1) substantially all of the use of the property had to 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 had to commence with the taxpayer on or after August 28, 2005; and (3) the property had to 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). This Act extended the placed-in-service deadline to December 31, 2010 for nonresidential real property and residential rental property located in those portions of the GO Zone in a county or parish in which hurricanes occurring in 2005 damaged more than 60 percent of the housing units. However, only the adjusted basis of such property attributable to manufacture, construction, or production before January 1, 2010 (“progress expenditures”) is eligible for the additional first-year depreciation.

***Extend IRS authority to fund undercover operations.***—The IRS is permitted to fund certain necessary and reasonable expenses of undercover operations, which places it on equal footing with other Federal law enforcement agencies. These undercover operations include international and domestic money laundering and narcotics operations. This Act extended this funding authority, which expired on December 31, 2006, through December 31, 2007.

***Extend provisions permitting disclosure of tax return information relating to terrorist activity.***—The disclosure of tax return information relating to terrorism is permitted 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. This Act extended this disclosure authority, which expired on December 31, 2006, through December 31, 2007.

***Extend provisions permitting disclosure of certain other tax return information.***—Certain law permits disclosure of taxpayer identity information and signatures to any agency, body, or commission of any State for the purpose of carrying out with such agency, body or commission a combined Federal and State employment tax reporting program approved by the Secretary of the Treasury. This Act extended this disclosure authority, which expired on December 31, 2006, through December 31, 2007.

### Energy Provisions

***Extend placed-in-service date for tax credit for energy produced from certain renewable sources.***—Taxpayers are allowed a tax credit for electricity produced from wind, closed-loop biomass, open-loop biomass, geothermal energy, solar energy, small irrigation power, municipal solid waste, and qualified hydropower. The credit rate is 1.5 cents per kilowatt hour for electricity produced from wind, closed-loop biomass, geothermal, and solar power, and 0.75 cent per kilowatt hour for electricity produced from open-loop biomass, small irrigation power, municipal solid waste, and qualified hydropower (both rates are adjusted for inflation since 1992). A credit is also provided for the production of refined coal and Indian coal at qualified facilities. The credit for refined coal is \$4.375 per ton (adjusted for inflation since 1992) and the credit for Indian coal is \$1.50 per ton for coal produced after December 31, 2005 and before January 1, 2010 and \$2.00 per ton for coal produced after December 31, 2009 and before January 1, 2013. To qualify for the credit under prior law, electricity generally had to be produced at a facility placed in service before January 1, 2008 (January 1, 2006, in the case of solar facilities) and coal had to be produced at a facility placed in service before January 1, 2009. This Act extended the placed-in-service date by one year, through December 31, 2008, for all facilities except solar energy, refined coal, and Indian coal facilities. For these facilities the placed-in-service termination dates of prior law were not changed.

***Extend and modify other energy tax provisions.***—Other energy tax provisions provided in this Act: (1) authorized the issuance of an additional \$400 million



of clean renewable energy bonds and extended the authority to issue such bonds through December 31, 2008; (2) modified the advanced coal credit with respect to sub-bituminous coal; (3) extended the deduction for expenditures associated with the installation of energy-efficient property in a commercial building; (4) extended the tax credit for the construction of qualified new energy-efficient homes to apply to homes the construction of which is substantially completed after December 31, 2005 and that are purchased after December 31, 2005 and before January 1, 2009; (5) extended the tax credit for the purchase of certain residential solar energy property to apply to property placed in service after December 31, 2005 and before January 1, 2009; and (6) extended the business energy tax credit for the cost of certain solar energy, microturbine, and fuel cell property to apply to property purchased before January 1, 2009.

### Health Savings Accounts

**Modify health savings accounts.**—Individuals with a high-deductible health plan (and no other health plan other than a plan that provides certain permitted coverage) may establish a health savings account (HSA). Individuals who may be claimed as a dependent on another person's tax return cannot establish HSAs and individuals who enroll in Medicare cannot make contributions to an HSA. In general, HSAs provide tax-favored treatment for current medical expenses as well as the ability to save on a tax-favored basis for future medical expenses. Contributions to an HSA may be made by both an individual and the individual's employer, all contributions are aggregated for purposes of the maximum annual contribution limit, and contributions to Archer MSAs reduce the annual contribution limit for HSAs. Contributions to an HSA made by an employer are excluded from income and employment taxes and, within limits, contributions to an HSA made by or on behalf of an eligible individual are deductible by the individual in determining AGI (whether or not the individual itemizes deductions). Earnings on amounts in an HSA are not taxable and distributions for qualified medical expenses are not included in gross income; however, distributions from an HSA that are not used for qualified medical expenses are included in gross income and except in the case of death, disability or the attainment of age 65, are subject to an additional tax of 10 percent. Under prior law, the maximum aggregate annual contribution that could be made to an HSA was the lesser of: (1) 100 percent of the annual deductible under the high deductible health plan or (2) for 2007, \$2,850 in the case of self-only coverage and \$5,650 in the case of family coverage. In the case of policy holders and covered spouses who were age 55 or older, the HSA annual contribution limit was greater than the otherwise applicable limit by \$700 in 2006, \$800 in 2007, \$900 in 2008, and \$1,000 in 2009 and subsequent years. This Act modified HSAs by: (1) allowing one-time rollovers of certain amounts (not greater than the balance on September 21, 2006)

from flexible spending arrangements (FSAs) and health reimbursement arrangements (HRAs) directly to HSAs, effective for distributions on or after December 20, 2006 and before January 1, 2012; (2) treating certain FSA coverage as disregarded coverage for purposes of determining if tax deductible contributions can be made to an HSA, effective for taxable years beginning after December 31, 2006; (3) repealing the provision that limited the maximum deductible contribution to the annual deductible under the high-deductible health plan, effective for taxable years beginning after December 31, 2006; (4) modifying the 12-month period over which the Consumer Price Index (CPI) for a calendar year is determined for purposes of making cost-of-living adjustments to HSA contribution limits and high-deductible health plan requirements, effective for adjustments for taxable years beginning after 2007; (5) allowing individuals who become eligible individuals in a month other than January to make the full deductible HSA contribution for the year, effective for taxable years beginning after December 31, 2006; (6) modifying employer comparable contribution requirements for contributions made to non-highly compensated employees; and (7) allowing one-time rollovers from IRAs directly to HSAs up to the annual HSA maximum contribution, effective for taxable years beginning after December 31 2006.

### Trade Measures

**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. This Act extended this program, which was scheduled to expire after December 31, 2006, through December 31, 2008. This Act also provided that the President should revoke any existing competitive need limitation (CNL) waiver that has been in effect for at least five years, if a GSP-eligible product from a specific country has an annual trade level in the previous calendar year that exceeds 150 percent of the annual trade cap or 75 percent of all U.S. imports of that product.

**Extend Andean Trade Preference Act (ATPA).**—The ATPA, which was scheduled to expire after December 31, 2006, was designed to provide economic alternatives for Bolivia, Columbia, Ecuador, and Peru in their fight against narcotics production and trafficking. This Act extended the ATPA for six-months through June 30, 2007. An additional six-month extension, through December 31, 2007, was granted to any ATPA beneficiary country that concludes a trade promotion agreement with the United States, provided the Congress and that country's legislature both approve the agreement by June 30, 2007.

**Modify African Growth and Opportunity Act (AGOA) and AGOA Acceleration Act.**—The African Growth and Opportunity Act (AGOA) and the AGOA

Acceleration Act, enacted in 2000 and 2004, respectively, reduced barriers to trade, thereby increasing U.S.-Africa trade, creating jobs, and increasing opportunities for Africans and Americans alike. This Act modified previous AGOA legislation by: (1) extending the deadline for use of third country fabric benefits, which was scheduled to expire after September 30, 2007, through September 30, 2012, with a 3.5 percent cap; (2) providing an exception to the third country fabric benefit for apparel goods made from fabric or yarn components that are in "abundant supply" in Africa; and (3) providing duty-free treatment to certain textiles and textile articles (non-apparel) of wholly made African fabric imported from lesser-developed AGOA beneficiaries.

**Other trade measures.**—This Act also: (1) authorized the President to grant permanent normal trade relations status to Vietnam; (2) provided new rules of origin for duty-free apparel imports from Haiti, subject to meeting statutory criteria; (3) offered temporary duty reductions on a variety of items not manufactured in the United States; and (5) extended the period from 15 to 30 days before changes made in the Harmonized Tariff Schedule of the United States to implement certain international tariff nomenclature obligations become effective.

#### Other Provisions

**Expand qualified mortgage bond program.**—Under current law, State and local governments may issue mortgage revenue bond (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 bonds issued after December 20, 2006 and before January 1, 2008, this Act waived the first-time homebuyer requirement with respect to financing for veterans who served in the active military. The exception applies without regard to the date the veteran last served on active duty or the date on which the veteran applied for the loan after leaving active duty; however, each veteran may use the exception only one time.

**Allow prepayment of premium liability for coal industry health benefits.**—The United Mine Workers of America (UMWA) Combined Benefit Fund was established by the Coal Industry Retiree Health Benefit Act of 1992 to assume responsibility of payments for medical care expenses of certain retired miners and their dependents. The Combined Benefit Fund is financed by assessments on current and former signatories to

labor agreements with the UMWA, past transfers from an overfunded United Mine Workers pension fund, and transfers from the Abandoned Mine Reclamation Fund. The Social Security Administration is responsible for assigning eligible retired miners and their dependents to current and former signatories to labor agreements with the UMWA and calculating annual contributions to be paid by each such signatory for each beneficiary assigned to the signatory. The term "assigned operator" is used to refer to the signatory to whom liability for a particular beneficiary of the Combined Benefit Fund has been assigned. Effective December 20, 2006, this Act allowed certain assigned operators to prepay their premium liability to the Combined Benefit Fund. Under this Act: (1) the payment by the assigned operator (or any related person on behalf of the assigned operator) must be no less than the present value of the total premium liability of the assigned operator, as determined by the operator's enrolled actuary, using actuarial methods and assumptions each of which is reasonable and which are reasonable in the aggregate; and (2) the enrolled actuary must file with the Department of Labor an actuarial report regarding the valuation made by the actuary.

**Provide other changes.**—Other provisions in this Act: (1) allowed U.S. businesses operating as branches in Puerto Rico to claim the domestic manufacturing deduction for two years; (2) allowed individuals to take advantage of a refundable credit with respect to certain long-term unused AMT credits existing prior to January 1, 2013; (3) allowed individuals to treat premiums paid or accrued before December 31, 2007 on qualified mortgage insurance contracts issued after January 1, 2007 as qualified mortgage interest (subject to income limits); (4) modified the excise tax on unrelated business taxable income of charitable remainder trusts; and (5) reformed the reward program for individuals who provide information regarding violations of the tax laws.

#### UNITED STATES-OMAN FREE TRADE AGREEMENT IMPLEMENTATION ACT

This Act, which was signed by President Bush on September 26, 2006, approved and provided for U.S. implementation of the United States-Oman Free Trade Agreement, as signed by the United States and Oman on January 19, 2006. When this Agreement enters into force, it will level the playing field for U.S. workers and businesses, provide additional market access for U.S. goods, help Oman's leaders develop long-term opportunities for their people, and advance our shared goal of building a Middle East Free Trade Area. By strengthening our relations with a strategic friend and ally in the Middle East, this Agreement will also help protect America's national security interests.

## ADMINISTRATION PROPOSALS

### IMPROVE THE TAX SYSTEM TO MAKE THE U.S. MORE COMPETITIVE

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 tax system should promote the competitiveness of American workers and businesses in the global economy. The Report of the President's Advisory Panel on Federal Tax Reform has helped lay groundwork on ways to ensure that our tax system better meets the needs of today's economy.

The President's tax relief enacted in 2001 and 2003 helped move the tax code in this direction. The President has proposed changes that would move the tax code yet further in this direction. The Budget includes proposals to make health care more affordable and consumer-driven, to promote savings for all Americans, and to encourage investment by entrepreneurs. The Budget also recognizes that tax policy analysis needs to account fully for the economic benefits of policy changes on our economy. In the coming months, the Treasury Department will engage in a public dialogue on how our tax system can be improved to make the U.S. more competitive in the global economy.

#### MAKE PERMANENT CERTAIN TAX RELIEF 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, 2009 and 2010) 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, 2010.

***Extend permanently increased expensing for small business.***—Under current law, beginning in 2010, taxpayers may expense up to \$25,000 in annual investment expenditures for qualifying property, and the maximum amount that may be expensed is reduced by the amount by which the taxpayer's cost of qualifying property exceeds \$200,000. Neither of these dollar amounts is indexed for inflation. However, under temporary provisions first enacted in 2003, 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 beginning in 2003 through 2009. The maximum amount that may be expensed is reduced by the amount by which the taxpayer's cost of qualifying property exceeds \$400,000. Both the temporary deduction and annual investment limits are indexed annually for inflation, effective for taxable years beginning after 2003 and before 2010. Also, with respect to a taxable year beginning after

2002 and before 2010, 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 2009.

***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 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 \$2,000 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 any time 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, 2007 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 before January 1, 2009 could spread the included conversion amount over four 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 roll-

overs 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, 2007.

### Encourage Entrepreneurship and Investment

**Increase expensing for small business.**—Business taxpayers are currently 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 beginning in 2003 through 2009. The maximum 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 2010. Also, with respect to a taxable year beginning after 2002 and before 2010, 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 2007. These higher amounts would be indexed for inflation, effective for taxable years beginning after 2008.

### Invest in Health Care

**Provide a flat \$15,000 deduction for family coverage (\$7,500 for individual coverage) for those with and who purchase health insurance.**—The Administration proposes to provide a flat \$15,000 deduction to all families who purchase health insurance (\$7,500 for those purchasing individual coverage), whether directly or through an employer, that meets minimum requirements. The full deduction would apply regardless of how much a family or individual spends on health insurance; that is, a family or individual that spends less than the full deduction on health insurance would still receive the full deduction. The deduction would apply for purposes of both the income and payroll tax.

The new, flat deduction would replace the existing exclusion for employer-provided health insurance, the self-employed premium deduction, and the medical itemized deduction for those under 65 years of age. The current exclusion or deduction from income of health care spending, whether for insurance premiums or out-of-pocket expenses, except under a Health Savings Account (HSA), would also be repealed. Employers would be required to report the value of health insurance coverage to their employees on their annual Form W-2 and such amounts would be subject to withholding and employment taxes. Businesses would continue to deduct employer-provided health insurance as a business expense. In addition, the phase-out rate for the EITC for taxpayers with qualifying children would be reduced to 15 percent. These provisions would be effective for tax years beginning after December 31, 2008.

**Expand and make health savings accounts (HSAs) more flexible.**—Current law allows individuals to accumulate funds in an 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, individual contributions to HSAs are deductible for income tax purposes, while employer contributions to HSAs are excluded from both the income and payroll tax. The higher de-

ductible under HSA-qualified health plans increases the cost consciousness of health care consumers by increasing their exposure to the cost of health care.

In addition to higher deductibles, the Administration also recognizes that higher coinsurance levels encourage cost consciousness among health care consumers. Therefore, the Administration proposes to allow health plans to be considered HSA-eligible if they meet all the existing requirements of an HDHP except that, in lieu of satisfying the minimum deductible requirement, they have at least a 50 percent coinsurance requirement and a minimum out-of-pocket exposure that would result in the same (or lower) premium as coverage under a high-deductible health plan under the current requirements for the same family or individual.

The Administration also proposes that additional changes be made to HSAs to encourage the use of HSAs and coverage under the HSA-eligible high-deductible health plans including: (1) allowing family coverage to include coverage where each individual in the family can receive benefits once they have reached the minimum deductible for an individual HDHP; (2) allowing both spouses to contribute the catch-up contribution to a single HSA owned by one spouse if both spouses are eligible individuals; (3) allowing an individual to be covered by a flexible spending arrangement (FSA) or health reimbursement arrangement (HRA) with first dollar coverage and still contribute to an HSA, but offset the maximum allowable HSA contribution by the level of FSA or HRA coverage; (4) 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; and (5) 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, 2007.

**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 Trade Adjustment Assistance (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, 2007. 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, 2007.

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, 2006.

### Provide Incentives for Charitable Giving

**Extend permanently tax-free withdrawals from IRAs for charitable contributions.**—Under current law, eligible individuals may make deductible or non-deductible contributions to a traditional IRA and non-deductible contributions to a Roth IRA. Pre-tax contributions and earnings in a traditional IRA are included in income when withdrawn. Qualified withdrawals from a Roth IRA are excluded from gross income; withdrawals that are not qualified are included

in gross income to the extent attributable to earnings. The Pension Protection Act of 2006 provided an exclusion from gross income for otherwise taxable distributions from a traditional or a Roth IRA made directly to a qualified charitable organization. The exclusion may not exceed \$100,000 per taxpayer per taxable year, is applicable only to distributions made on or after the date the IRA owner attains age 70½, and is effective for distributions made in taxable years beginning after December 31, 2005 and before January 1, 2008. The exclusion applies only if a charitable contribution deduction for the entire distribution would otherwise be allowable under current law, determined without regard to the percentage-of-AGI limitation. No charitable deduction is allowed with respect to any amount excludable from income under this provision.

The Administration proposes to permanently extend this exclusion, effective for distributions made in taxable years beginning after December 31, 2007.

***Extend permanently 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, or, if less, the fair market value of 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.

The Katrina Emergency Tax Relief Act of 2005 expanded the enhanced deduction to apply to qualified contributions of food inventory made after August 27, 2005 and before January 1, 2006 by all taxpayers (not just C corporations) engaged in a trade or business. The Pension Protection Act of 2006 extended the enhanced charitable deduction for contributions of food inventory provided under the Katrina Emergency Tax Relief Act of 2005 to apply to contributions made after December 31, 2005 and before January 1, 2008. The donated food must meet certain quality and labeling standards, and, for taxpayer's other than C corporations, the total deduction for donated food inventory may not exceed 10 percent of the taxpayer's net income from the related trade or business. The Administration proposes to permanently extend the enhanced charitable deduction for contributions of food inventory to apply to contributions made after December 31, 2007.

***Extend permanently the deduction for corporate donations of computer technology.***—The charitable contribution deduction that may be claimed by corporations for donations of inventory property generally is limited to the lesser of fair market value or the corporation's basis in the property. However, corporations are provided enhanced deductions, not subject to this limitation, for contributions of computer technology and equipment for education purposes. The enhanced deduction is equal to the lesser of: (1) basis plus one-half of the item's fair market value in excess of basis, or (2) two times basis. To qualify for the enhanced deduction, equipment contributed must have been constructed or assembled by the taxpayer and be donated no later than three years after completion. This provision expires with respect to donations made after December 31, 2007. The Administration proposes to permanently extend this deduction, effective for distributions made in taxable years beginning after December 31, 2007.

***Permanently increase limits on contributions of property interests made for conservation purposes.***—In general, a deduction is permitted for charitable contributions, subject to certain limitations that depend on the type of taxpayer, the property contributed, and the donee organization. Exceptions to these general rules are provided for certain types of contributions, including qualified conservation contributions. The special rules for qualified conservation contributions were enhanced under the Pension Reform Act of 2006, applicable for qualified conservation contributions made in taxable years beginning after December 31, 2005 and before January 1, 2008. These special rules: (1) increased the cap on deductions for qualified conservation contributions from 30 percent to 50 percent of the excess of the donor's contribution base over the amount of all other allowable charitable contributions, (2) increased the cap on deductions for qualified conservation contributions applicable to qualified ranchers and farmers to 100 percent of the excess of the donor's contribution base over the amount of all other allowable charitable contributions in the case of individuals and to 100 percent of the excess of taxable income over the amount of all other allowable charitable contributions in the case of corporations, and (3) increased the number of years qualified conservation contributions in excess of the 50- and 100-percent caps may be carried forward from five to 15 years. The Administration proposes to permanently extend these special rules, applicable for qualified conservation contributions made in taxable years beginning after December 31, 2007.

***Extend permanently basis adjustment to stock of S corporations contributing appreciated property.***—Each shareholder of an S corporation must take into account his or her pro rata share of a charitable contribution by the S corporation in determining his or her income tax liability. For donations of property, this generally is the pro rata share of the property's fair market value. Under prior law, the shareholder's

basis in the stock of the company was reduced by the amount of the charitable contribution that flowed through to the shareholder. Under the Pension Protection Act of 2006, effective for charitable contributions made by an S corporation in taxable years beginning after December 31, 2005 and before January 1, 2008, shareholders are allowed to adjust their basis in the stock of the company by their pro rata share of the adjusted basis of the contributed property instead of by their pro rata share of the market value of the contributed property. The Administration proposes to permanently extend this provision, effective for charitable contributions made by an S corporation in taxable years beginning after December 31, 2007.

**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 that 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, 2007.

**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 permanently 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 (deductible above-the-line). 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. This additional deduction is effective for expenses incurred in taxable years beginning after December 31, 2001 and before January 1, 2008. The Administration proposes to extend permanently the above-the-line deduction to apply to qualified out-of-pocket expenditures incurred in taxable years beginning after December 31, 2007.

**Allow the saver's credit for contributions to qualified tuition programs (section 529 of the Internal Revenue Code).**—Under current law, taxpayers age 18 or older who are not dependents or full-time students may receive a nonrefundable credit (the saver's credit) on up to \$2,000 of their compensation contributed to employer-sponsored qualified retirement plans and IRAs. The credit ranges between 10 and 50 percent of the amount contributed, depending on the taxpayer's filing status and AGI (adjusted for inflation). In determining the credit, qualified contributions are reduced by distributions from qualified plans and IRAs during the current tax year, the two preceding tax years, and the following year, up to the due date of the return, including extensions.

Under current law, taxpayers may contribute to a section 529 qualified tuition program (QTP) to save for higher education expenses of a designated beneficiary. Contributions to a QTP are not deductible from income for Federal tax purposes, but earnings on contributions accumulate tax-free. Taxpayers may exclude from gross

income amounts distributed from a QTP and used for qualified higher education expenses, provided the distribution is not used for the same educational expenses for which another tax benefit is claimed. Nonqualified distributions are subject to an additional tax.

The Administration proposes to allow the saver's credit for qualified contributions to QTPs controlled by the taxpayer. AGI would be modified to include the excludable portion of the taxpayer's Social Security benefits in determining the applicable rate for the saver's credit. The credit would apply to an annual aggregate contribution of up to \$2,000 (or earnings includible in gross income, if less) to the taxpayer's elective deferral plans, IRAs, and QTPs. For an individual who is married filing a joint return, the earnings limitation would be binding only if the combined includible compensation of the spouses was less than \$4,000. Qualified contributions would be reduced by distributions from elective deferral plans, IRAs, and QTPs during the current tax year, the two preceding tax years, and the following tax year up to the due date of the return, including extensions. The credit would be effective for years beginning after December 31, 2007.

### Protect the Environment

**Extend permanently expensing of brownfields remediation costs.**—Taxpayers may elect, with respect to expenditures paid or incurred before January 1, 2008, 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, 2007, and facilitating its use by businesses to undertake projects that may be uncertain in overall duration.

**Eliminate the volume cap for private activity bonds for water infrastructure.**—Bonds are classified as private activity bonds if they meet a private business use test and a private payments test. Private activity bonds may be issued on a tax-exempt basis only if they meet specified requirements, including targeting requirements that limit such bond financing to specifically defined facilities and programs. For example, qualified private activity bonds can be used to finance facilities for the furnishing of water and for sewer facilities. Qualified private activity bonds are subject to the same general rules applicable to governmental bonds. Most qualified private activity bonds are also subject to a number of additional rules and limitations, in particular an annual State volume cap limitation.

The Administration proposes to remove from the annual State volume cap limitation qualified private activity bonds issued to finance water and sewage facilities. Municipalities that use these bonds for wastewater and drinking water systems must implement (if they have not already) full-cost pricing for services, to help their

systems become self-financing like the electric and gas utilities and minimize the need for future Federal financing. The volume cap would be removed for obligations issued after December 31, 2007.

### Restructure Assistance to New York City for Continued Recovery from the Attacks of September 11<sup>th</sup>

**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. The Administration also proposes to terminate the additional first-year depreciation deduction for certain real property, which was provided to eligible property within the New York Liberty Zone under the 2002 economic stimulus act.

### 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 in-



comes, 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 the tax code.

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 AGI 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, 2007.

***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 simplification of the filing status and residency requirements would be effective for taxable years beginning after December 31, 2007. Effective January 1, 2008, the proposal would also improve the administration of the EITC with respect to eligibility requirements for undocumented workers.

***Reduce computational complexity of refundable child tax credit.***—Taxpayers with earned income in

excess of \$11,750 may qualify for a refundable (or “additional”) child tax credit even if they do not have any income tax liability. Over 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, 2007.

### IMPROVE TAX COMPLIANCE

The Federal tax system is based on voluntary compliance with the tax laws. Under this system, taxpayers report and pay their taxes voluntarily with minimal interaction with the IRS. While the vast majority of American taxpayers pay their taxes timely and accurately, there remains in aggregate a difference between what taxpayers should pay and what they actually pay on a timely basis. In 2001, the overall compliance rate was 86 percent, after including late payments and recoveries from IRS enforcement activities. While this rate of compliance is high, a large amount of the tax that should be paid is not, resulting in the so-called “tax gap”.<sup>1</sup>

In September 2006, the Treasury Department released a comprehensive strategy to improve tax compliance.<sup>2</sup> The strategy builds upon the demonstrated experience and current efforts of the Treasury Department and IRS to improve compliance.

Four key principles guided development of the strategy:

- Unintentional taxpayer errors and intentional taxpayer evasion should both be addressed.
- Sources of non-compliance should be targeted with specificity.
- Enforcement activities should be combined with a commitment to taxpayer service.
- Tax policy and compliance proposals should be sensitive to taxpayer rights and maintain an appropriate balance between enforcement activity and imposition of taxpayer burden.

<sup>1</sup> See Chapter 13, Stewardship, in the *Analytical Perspectives* volume.

<sup>2</sup> Comprehensive Strategy for Reducing the Tax Gap, U.S. Treasury Department, September 26, 2006.

These principles point to the need for a comprehensive, integrated, multi-year strategy to improve tax compliance. Components of this strategy must include: (1) legislative proposals to reduce opportunities for evasion; (2) a multi-year commitment to compliance research; (3) continued improvements in information technology; (4) improvements in IRS compliance activities; (5) enhancements of taxpayer service; (6) simplification of the tax law; and (7) coordination between the government and its partners and stakeholders.

The IRS has taken a number of steps to improve compliance. To enhance the IRS' efforts, the Administration's Budget includes a number of legislative proposals intended to improve tax compliance with minimum taxpayer burden. The Administration proposes to expand information reporting, improve compliance by businesses, strengthen tax administration, and expand penalties.

**Expand information reporting.**—Compliance with the tax laws is highest when payments are subject to information reporting to the IRS. Specific information reporting proposals would: (1) require information reporting on payments to corporations; (2) require basis reporting on security sales; (3) expand broker information reporting; (4) require information reporting on merchant payment card reimbursements; (5) require a certified tax identification number (TIN) from non-employee service providers; (6) require increased information reporting for certain government payments for property and services; and (7) increase information return penalties.

**Improve compliance by businesses.**—Improving compliance by businesses of all sizes is important. Specific proposals to improve compliance by businesses would: (1) require electronic filing by certain large businesses; (2) implement standards clarifying when employee leasing companies can be held liable for their clients' Federal employment taxes; and (3) amend collection due process procedures applicable to employment tax liabilities.

**Strengthen tax administration.**—The IRS has taken a number of steps under existing law to improve compliance. These efforts would be enhanced by specific tax administration proposals that would: (1) expand IRS access to information in the National Directory of New Hires database; (2) permit the IRS to disclose to prison officials return information about tax violations; and (3) make repeated failure to file a tax return a felony.

**Expand penalties.**—Penalties play an important role in discouraging intentional non-compliance. Specific proposals to expand penalties would: (1) expand preparer penalties; (2) impose a penalty on failure to comply with electronic filing requirements; and (3) create an erroneous refund claim penalty.

## IMPROVE TAX ADMINISTRATION AND OTHER MISCELLANEOUS PROPOSALS

**Implement IRS administrative reforms.**—The Administration has four proposals relating to administrative reforms. The first proposal 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 proposal allows the IRS to terminate installment agreements when taxpayers fail to make timely tax deposits and file tax returns on current liabilities. The third proposal 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. The fourth proposal modifies the way that Financial Management Services (FMS) recovers its transaction fees for processing IRS levies by permitting FMS to add the fee to the liability being recovered thereby shifting the cost of collection to the delinquent taxpayer. The offset amount would be included as part of the 15-percent limit on continuous levies against income.

**Extend IRS authority to fund undercover operations.**—The IRS is permitted to fund certain necessary and reasonable expenses of undercover operations, placing it on equal footing with other Federal law enforcement agencies. 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, 2007, through December 31, 2010.

**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, 2007.

**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.

**Repeal telephone tax on local telephone service.**—Under prior law, a three-percent Federal excise tax was imposed on amounts paid for local telephone service, toll telephone service (essentially long distance telephone service), and teletypewriter exchange service. In accordance with multiple court decisions that concluded that the tax did not apply to long distance services sold at flat per-minute rates for interstate, intrastate, and international calls, the IRS is no longer collecting tax on telephone service other than local-only telephone service. The Administration proposes to repeal the tax on local telephone service effective for amounts paid pursuant to bills first rendered more than 90 days after enactment of legislation repealing the tax.

**Modify financing of the Airport and Airway trust fund.**—The Administration supports a reauthorization proposal that would make the Federal Aviation Administration's (FAA's) financing system more cost-based. The FAA's current excise tax system, largely based on taxes on the price of airline tickets, does not have a

direct relationship between the taxes paid by users and the air traffic control services provided by the FAA. Under the reauthorization proposal, FAA would collect user fees from commercial aviation operators for air traffic control services starting in 2009. For non-commercial users, FAA would continue to recover its costs for air traffic control services via a fuel tax. Both commercial and non-commercial users would continue to pay fuel taxes to support FAA's Airport Improvement Program.

**Anticipated receipt of donations to the National Park Service through the National Park Centennial Challenge Fund.**—The President's National Parks Centennial Challenge encourages the public to increase donations to national parks by proposing to match contributions for signature projects and programs on a dollar-for-dollar basis up to \$100 million a year for ten years. As part of a broader initiative to prepare for the National Park Service Centennial in 2016, this Challenge continues the National Park Service's legacy of leveraging philanthropic investment for the benefit of our national parks.

**Transition from the non-foreign cost-of-living adjustment (COLA) to locality pay for employees in non-foreign areas.**—Federal employees working outside the continental United States in Alaska, Hawaii or the US territories presently receive a COLA, which is an untaxed annual pay adjustment that is not creditable for retirement. By transitioning to locality pay, Federal employees in the non-foreign areas will contribute a larger percentage of their pay into the Federal retirement fund as locality pay is retirement-creditable. The proposal would establish a yearly reduction in the COLA, offset by a yearly increase in applicable locality pay, with the intent of eliminating the COLA over seven years.

## IMPROVE 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 improve the administration of the UI program, such as speeding reemployment of UI beneficiaries. 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 Federal unemployment tax on employers is scheduled to drop from 0.8 percent to 0.6 percent with respect to wages paid after December 31, 2007. The 0.8 percent rate is proposed to be extended for five years, through December 31, 2012.

### MODIFY ENERGY PROVISIONS

**Repeal reduced recovery period for natural gas distribution lines.**—The Energy Policy Act of 2005 reduced the recovery period for new natural gas distribution lines that are placed in service before January 1, 2011 from 20 years to 15 years. The Administration proposes to repeal this provision for natural gas distribution lines placed in service after December 31, 2007.

**Modify 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. Under the Energy Policy Act of 2005, 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, could be amortized over two years. The Tax Increase Prevention and Reconciliation Act of 2006 increased the amortization period to five years for G&G costs paid or incurred by certain major integrated oil companies after May 17, 2006. This five-year amortization rule applies only to integrated oil companies that have an average daily worldwide production of crude oil of at least 500,000 barrels for the taxable year, have gross receipts in excess of \$1 billion in the last taxable year ending during calendar year 2005, and either are a crude oil refiner or have an ownership interest in a crude oil refiner of 15 percent or more. The Administration proposes to increase the amortization period to five years for all companies, effective for amounts paid or incurred in taxable years beginning after December 31, 2007.

### PROMOTE TRADE

**Implement free trade agreements.**—Free trade agreement negotiations with Panama were completed, with the expectation that implementation could begin as early as FY 2008. The FTA signed with Peru and

the recently completed agreement with Colombia could also begin implementation in FY 2008. Free trade agreements are expected to be completed with Korea, Malaysia, and the United Arab Emirates (UAE), with implementation to begin in FY 2009. 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.

**Establish Reconstruction Opportunity Zones (ROZs) in Pakistan and Afghanistan.**—In March 2006, the President announced his intention to establish ROZs in Afghanistan and the border regions of Pakistan. ROZs are a critical part of the Administration's broader counterterrorism strategy in these areas, designed to connect isolated regions to the global economy and create vital employment opportunities in territories prone to extremism. The creation of ROZs will encourage investment and economic development in these areas by granting duty-free entry to the United States for certain goods produced in designated territories. By stimulating economic activity in remote and underdeveloped regions, ROZs can also serve as a powerful catalyst for peace, prosperity, stability, growth and good governance. In early 2007, the Administration will work closely with Congress and private sector stakeholders to implement this important initiative.

### EXTEND EXPIRING PROVISIONS

**Extend AMT relief for individuals.**—A temporary provision of current law increased the AMT exemption amounts to \$42,500 for single taxpayers, \$62,550 for married taxpayers filing a joint return and surviving spouses, and \$31,275 for married taxpayers filing a separate return and estates and trusts. Effective for taxable years beginning after December 31, 2006, 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. A temporary provision of current law permits nonrefundable personal tax credits to offset both the regular tax and the AMT for taxable years beginning before January 1, 2007.

The Administration proposes to increase the AMT exemption amounts to \$43,900 for single taxpayers, \$65,350 for married taxpayers filing a joint return, and \$32,675 for married taxpayers filing a separate return and estates and trusts through taxable year 2007 to prevent the number of AMT taxpayers from increasing. Non-refundable personal tax credits also would be allowed to offset both the regular tax and the AMT through taxable year 2007.

**Extend permanently the research and experimentation (R&E) tax credit.**—The Administration proposes to extend permanently the tax credits for research and experimentation expenditures, which are

scheduled to expire with respect to expenditures incurred after December 31, 2007.

***Extend the work opportunity tax credit.***—The work opportunity tax credit provides incentives for hiring individuals from certain targeted groups. The credit applies to wages paid to qualified individuals who begin work for the employer before January 1, 2008. The Administration proposes to extend the credit for one year, making it applicable to wages paid to qualified individuals who begin work after December 31, 2007 and before January 1, 2009.

***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, 2007. The Administration proposes to extend the credit for one year, making the credit available with respect to purchases after December 31, 2007 and before January 1, 2009.

***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 2007. 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 2007 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 2008; unused authority could be carried forward for up to two years. Reporting of issuance would be required.

***Extend deferral of gains from sales of electric transmission property.***—Generally, the gain on the sale of business assets is subject to current income tax unless a special rule provides for nonrecognition or deferral of the gain. One such special rule applies to qualifying electric transmission transactions. Under this rule, a taxpayer may elect to recognize the gain from a qualifying electric transmission transaction ratably over the eight-year period beginning with the year of the transaction. Deferral is allowed only with respect

to proceeds that are used to purchase other gas or electric utility property during the four-year period beginning on the date of the transaction (the reinvestment period). A sale or other disposition of property is a qualifying electric transmission transaction if: (1) the property is used in the trade or business of providing electric transmission services or is an ownership interest in a entity whose principal trade or business is providing electric transmission services, and (2) the sale or other disposition is to an independent transmission company and occurs before January 1, 2008. In general, whether the purchaser qualifies as an independent transmission company depends on determinations by the Federal Energy Regulatory Commission (FERC) or, in the case of facilities subject to the jurisdiction of the Public Utility Commission of Texas, by that Commission. The special rule allowing the deferral of tax on the gain from the sale or disposition of electric transmission property would be extended for one year, allowing taxpayers to elect deferral with respect to sales or dispositions that occur before January 1, 2009.

***Extend provisions permitting disclosure of tax return information relating to terrorist activity.***—The disclosure of tax return information relating to terrorism is permitted 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, 2007, through December 31, 2008.

***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.

**Extend the exception for retirement plan distributions provided individuals called to active duty for at least 179 days.**—Under current law, a taxpayer who receives a distribution from a qualified retirement plan prior to age 59½, death or disability is subject to a 10-percent early withdrawal tax unless a specific exception to the tax applies. One of the exceptions to the tax applies to qualified reservist distributions. An individual who receives a qualified reservist distribution may, at any time during a two-year period beginning on the day after the end of the active duty

period, make contributions to an IRA in an amount not exceeding the amount of the qualified reservist distribution. Such contributions are not subject to the dollar limitations otherwise applicable to contributions to IRAs. The exception to the tax for qualified reservist distributions applies to individuals ordered or called to active duty after September 11, 2001 and before December 31, 2007. The Administration proposes to extend the exception to individuals ordered or called to active duty before December 31, 2008.

**Table 17-3. EFFECT OF PROPOSALS ON RECEIPTS**

(In millions of dollars)

	2007	2008	2009	2010	2011	2012	2008-12	2008-17
<b>Make Permanent Certain Tax Relief Enacted in 2001 and 2003 (assumed in the baseline):</b>								
Dividends tax rate structure .....	344	683	695	-3,595	-13,789	1,491	-14,515	-89,973
Capital gains tax rate structure .....				-3,405	-17,477	-7,269	-28,151	-79,059
Expensing for small business .....				-3,728	-4,947	-3,376	-12,051	-20,158
Marginal individual income tax rate reductions .....					-71,892	-113,251	-185,143	-793,780
Child tax credit <sup>1</sup> .....					-5,265	-21,128	-26,393	-135,380
Marriage penalty relief <sup>1</sup> .....					-5,380	-7,971	-13,351	-41,317
Education incentives .....					-739	-1,336	-2,075	-9,673
Repeal of estate and generation-skipping transfer taxes, and modification of gift taxes .....	-156	-1,373	-2,290	-3,067	-26,845	-57,652	-91,227	-442,490
Other incentives for families and children .....				6	-179	-866	-1,039	-5,341
Total, make permanent certain tax relief enacted in 2001 and 2003	188	-690	-1,595	-13,789	-146,513	-211,358	-373,945	-1,617,171
<b>Tax Incentives:</b>								
<b>Simplify and encourage saving:</b>								
Expand tax-free savings opportunities .....		1,527	3,545	3,023	1,075	-1,314	7,856	-592
Consolidate employer-based savings accounts .....		-80	-120	-132	-141	-150	-623	-1,484
Total, simplify and encourage saving .....		1,447	3,425	2,891	934	-1,464	7,233	-2,076
<b>Encourage entrepreneurship and investment:</b>								
Increase expensing for small business .....		-1,597	-2,180	-1,541	-1,135	-847	-7,300	-10,095
<b>Invest in health care:</b>								
Provide a flat \$15,000 deduction for family coverage (\$7,500 for individual coverage) for those with and who purchase health insurance <sup>1</sup> .....			-31,433	-38,892	-30,843	-20,033	-121,201	5,150
Expand and make health savings accounts (HSAs) more flexible .....		-318	-593	-784	-937	-1,037	-3,669	-10,366
Improve the Health Coverage Tax Credit <sup>1</sup> .....		-1	-3	-4	-5	-5	-18	-51
Allow the orphan drug tax credit for certain pre-designation expenses ..								-1
Total, invest in health care .....		-319	-32,029	-39,680	-31,785	-21,075	-124,888	-5,268
<b>Provide incentives for charitable giving:</b>								
Extend permanently tax-free withdrawals from IRAs for charitable contributions .....		-120	-255	-235	-171	-147	-928	-1,867
Extend permanently the enhanced charitable deduction for contributions of food inventory .....		-44	-96	-106	-116	-127	-489	-1,345
Extend permanently the deduction for corporate donations of computer technology .....		-50	-118	-147	-154	-162	-631	-1,570
Permanently increase limits on contributions of property interests made for conservation purposes .....		-48	-35	-22	-18	-21	-144	-265
Extend permanently basis adjustment to stock of S corporations contributing appreciated property .....		-3	-15	-21	-25	-28	-92	-301
Reform excise tax based on investment income of private foundations .....		-61	-91	-97	-103	-110	-462	-1,163
Repeal the \$150 million limitation on qualified 501(c)(3) bonds .....		-2	-3	-9	-13	-14	-41	-104
Repeal certain restrictions on the use of qualified 501(c)(3) bonds for residential rental property .....		-2	-5	-10	-17	-24	-58	-286
Total, provide incentives for charitable giving .....		-330	-618	-647	-617	-633	-2,845	-6,901
<b>Strengthen education:</b>								
Extend permanently the above-the-line deduction for qualified out-of-pocket classroom expenses .....		-18	-180	-183	-185	-188	-754	-1,739



Table 17-3. EFFECT OF PROPOSALS ON RECEIPTS—Continued

(In millions of dollars)

	2007	2008	2009	2010	2011	2012	2008-12	2008-17
Exception for retirement plan distributions provided individuals called to active duty for at least 179 days .....	_*	_*	_*	_*	_*	_*	_*	_*
Total, extend expiring provisions <sup>2</sup> .....	-9,186	-51,266	4,089	-9,385	-10,738	-11,865	-79,165	-153,442
<b>Total budget proposals, including proposals assumed in the baseline<sup>2</sup></b> .....	-9,386	-52,166	-33,825	-66,771	-194,308	-251,935	-599,005	-1,854,496
<b>Total budget proposals, excluding proposals assumed in the baseline<sup>2</sup></b> .....	-9,574	-51,476	-32,230	-52,982	-47,795	-40,577	-225,060	-237,325

\* \$500,000 or less.

<sup>1</sup> Affects both receipts and outlays. Only the receipt effect is shown here. For the outlay effect, see summary Table S-5 of the *Budget* volume.<sup>2</sup> Net of income offsets.<sup>3</sup> Indirect effect on receipts of proposed alternative fuels and fuel efficiency standards. These proposals are discussed in the Energy chapter of the *Budget* volume.<sup>4</sup> No net budgetary impact.<sup>5</sup> "Tax gap"-related proposals.



Table 17-4. RECEIPTS BY SOURCE

(In millions of dollars)

Source	2006 Actual	Estimate					
		2007	2008	2009	2010	2011	2012
<b>Individual income taxes (federal funds):</b>							
Existing law .....	1,043,908	1,177,703	1,294,636	1,349,248	1,476,448	1,673,666	1,819,724
Proposed legislation .....		-8,857	-48,022	-18,111	-48,131	-156,377	-183,157
<b>Total individual income taxes .....</b>	<b>1,043,908</b>	<b>1,168,846</b>	<b>1,246,614</b>	<b>1,331,137</b>	<b>1,428,317</b>	<b>1,517,289</b>	<b>1,636,567</b>
<b>Corporation income taxes:</b>							
Federal funds:							
Existing law .....	353,914	341,867	318,385	326,647	334,665	350,891	377,546
Proposed legislation .....		190	-3,444	-6,837	-9,206	-10,314	-10,910
Total Federal funds corporation income taxes .....	353,914	342,057	314,941	319,810	325,459	340,577	366,636
Trust funds:							
Hazardous substance superfund .....	1						
<b>Total corporation income taxes .....</b>	<b>353,915</b>	<b>342,057</b>	<b>314,941</b>	<b>319,810</b>	<b>325,459</b>	<b>340,577</b>	<b>366,636</b>
<b>Social insurance and retirement receipts (trust funds):</b>							
Employment and general retirement:							
Old-age and survivors insurance (Off-budget) .....	520,069	542,098	576,237	608,106	643,935	680,272	714,061
Disability insurance (Off-budget) .....	88,313	92,032	97,848	103,264	109,347	115,518	121,256
Hospital insurance .....	177,429	185,163	198,726	208,700	221,160	233,811	245,766
Railroad retirement:							
Social Security equivalent account .....	1,894	1,993	2,073	2,137	2,203	2,258	2,319
Rail pension and supplemental annuity .....	2,338	2,364	2,441	2,529	2,473	2,507	2,712
Total employment and general retirement .....	790,043	823,650	877,325	924,736	979,118	1,034,366	1,086,114
On-budget .....	181,661	189,520	203,240	213,366	225,836	238,576	250,797
Off-budget .....	608,382	634,130	674,085	711,370	753,282	795,790	835,317
Unemployment insurance:							
Deposits by States <sup>1</sup> .....	35,938	37,574	37,584	36,792	37,203	38,150	39,352
Proposed legislation .....				36	36	-20	-108
Federal unemployment receipts <sup>1</sup> .....	7,394	7,323	6,183	5,785	5,925	6,065	6,207
Proposed legislation .....			1,341	1,928	1,975	2,022	2,069
Railroad unemployment receipts <sup>1</sup> .....	88	88	95	106	112	114	122
Total unemployment insurance .....	43,420	44,985	45,203	44,647	45,251	46,331	47,642
Other retirement:							
Federal employees' retirement—employee share .....	4,308	4,704	4,633	4,798	4,909	4,964	4,972
Proposed legislation .....			1	2	3	4	5
Non-Federal employees retirement <sup>2</sup> .....	50	38	33	31	28	26	23
Total other retirement .....	4,358	4,742	4,667	4,831	4,940	4,994	5,000
<b>Total social insurance and retirement receipts .....</b>	<b>837,821</b>	<b>873,377</b>	<b>927,195</b>	<b>974,214</b>	<b>1,029,309</b>	<b>1,085,691</b>	<b>1,138,756</b>
On-budget .....	229,439	239,247	253,110	262,844	276,027	289,901	303,439
Off-budget .....	608,382	634,130	674,085	711,370	753,282	795,790	835,317
<b>Excise taxes:</b>							
Federal funds:							
Alcohol taxes .....	8,484	8,614	8,798	8,953	9,109	9,318	9,524
Proposed legislation .....			-76	-26			
Tobacco taxes .....	7,710	7,605	7,496	7,393	7,298	7,208	7,123
Transportation fuels tax .....	-2,386	-2,960	-3,459	-4,101	-4,798	-1,227	234
Proposed legislation .....			-74	-139	-190	-57	
Telephone and teletype services .....	4,897	-10,892	-1,712	197	100	100	100
Proposed legislation .....		-736	-616	-197	-100	-100	-100
Other Federal fund excise taxes .....	3,755	1,493	1,932	1,987	2,057	2,128	2,208
Proposed legislation .....			15	-121	-155	-163	-172
Total Federal fund excise taxes .....	22,460	3,124	12,304	13,946	13,321	17,207	18,917

Table 17-4. RECEIPTS BY SOURCE—Continued

(In millions of dollars)

Source	2006 Actual	Estimate					
		2007	2008	2009	2010	2011	2012
<b>Trust funds:</b>							
Highway .....	38,378	39,707	40,858	41,911	42,696	43,402	44,045
Proposed legislation .....			12	14	-27	-65	-131
Airport and airway .....	10,590	11,426	12,094	12,808	13,556	14,341	15,162
Proposed legislation .....				-8,485	-8,882	-9,279	-9,706
Sport fish restoration and boating safety .....	519	547	564	581	600	619	638
Tobacco assessments .....	891	960	960	960	960	960	960
Black lung disability insurance .....	607	624	629	640	659	679	692
Inland waterway .....	81	84	85	86	87	88	89
Oil spill liability .....	54	199	205	214	225	233	244
Vaccine injury compensation .....	184	195	196	198	199	202	203
Leaking underground storage tank .....	197	196	199	204	206	210	212
<b>Total trust funds excise taxes .....</b>	<b>51,501</b>	<b>53,938</b>	<b>55,802</b>	<b>49,131</b>	<b>50,279</b>	<b>51,390</b>	<b>52,408</b>
<b>Total excise taxes .....</b>	<b>73,961</b>	<b>57,062</b>	<b>68,106</b>	<b>63,077</b>	<b>63,600</b>	<b>68,597</b>	<b>71,325</b>
<b>Estate and gift taxes:</b>							
Federal funds .....	27,877	25,260	26,786	28,757	22,920	20,407	48,691
Proposed legislation .....		17	-1,081	-1,318	-1,179	-18,733	-48,170
<b>Total estate and gift taxes .....</b>	<b>27,877</b>	<b>25,277</b>	<b>25,705</b>	<b>27,439</b>	<b>21,741</b>	<b>1,674</b>	<b>521</b>
<b>Customs duties:</b>							
Federal funds .....	23,533	25,430	28,105	29,786	32,066	33,837	35,501
Proposed legislation .....			-322	-671	-1,015	-1,326	-1,655
Trust funds .....	1,277	1,336	1,440	1,536	1,637	1,740	1,849
<b>Total customs duties .....</b>	<b>24,810</b>	<b>26,766</b>	<b>29,223</b>	<b>30,651</b>	<b>32,688</b>	<b>34,251</b>	<b>35,695</b>
<b>MISCELLANEOUS RECEIPTS:<sup>3</sup></b>							
Miscellaneous taxes .....	423	534	542	549	558	567	577
Exercise of warrants .....	118						
United Mine Workers of America combined benefit fund .....	119	72	65	44	24	5	3
Deposit of earnings, Federal Reserve System .....	29,945	32,638	36,115	37,625	39,040	40,680	42,804
Defense cooperation .....	12	8	8	8	8	8	8
Fees for permits and regulatory and judicial services .....	10,226	10,083	10,468	10,600	10,806	11,020	11,213
Fines, penalties, and forfeitures .....	3,796	3,243	3,254	2,910	2,929	2,948	2,969
Gifts and contributions .....	378	189	194	199	201	203	206
Proposed legislation .....			100	100	100	100	100
Refunds and recoveries .....	-55	-56	-56	-56	-56	-56	-56
<b>Total miscellaneous receipts .....</b>	<b>44,962</b>	<b>46,711</b>	<b>50,690</b>	<b>51,979</b>	<b>53,610</b>	<b>55,475</b>	<b>57,824</b>
<b>Total budget receipts .....</b>	<b>2,407,254</b>	<b>2,540,096</b>	<b>2,662,474</b>	<b>2,798,307</b>	<b>2,954,724</b>	<b>3,103,554</b>	<b>3,307,324</b>
On-budget .....	1,798,872	1,905,966	1,988,389	2,086,937	2,201,442	2,307,764	2,472,007
Off-budget .....	608,382	634,130	674,085	711,370	753,282	795,790	835,317
<b>MEMORANDUM</b>							
Federal funds .....	1,517,453	1,635,493	1,681,337	1,774,042	1,874,190	1,965,503	2,115,280
Trust funds .....	616,863	653,127	692,062	709,365	747,034	789,414	827,684
Interfund transactions .....	-335,444	-382,654	-385,010	-396,470	-419,782	-447,153	-470,957
<b>Total on-budget .....</b>	<b>1,798,872</b>	<b>1,905,966</b>	<b>1,988,389</b>	<b>2,086,937</b>	<b>2,201,442</b>	<b>2,307,764</b>	<b>2,472,007</b>
<b>Off-budget (trust funds) .....</b>	<b>608,382</b>	<b>634,130</b>	<b>674,085</b>	<b>711,370</b>	<b>753,282</b>	<b>795,790</b>	<b>835,317</b>
<b>Total .....</b>	<b>2,407,254</b>	<b>2,540,096</b>	<b>2,662,474</b>	<b>2,798,307</b>	<b>2,954,724</b>	<b>3,103,554</b>	<b>3,307,324</b>

<sup>1</sup> 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 administrative costs of the program for the railroads.

<sup>2</sup> 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.

<sup>3</sup> 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 user charges, most 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.<sup>1</sup> In addition, some regulatory fees therefore are classified as governmental receipts and are on the receipts side of the budget.

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 2008, total offsetting collections and receipts from the public are estimated to be \$319.3 billion, and total user charges are estimated to be \$244.6 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. Collections specifically related to credit programs are discussed in Chapter 7, “Credit and Insurance.”

**Table 18–1. GROSS OUTLAYS, USER CHARGES, OTHER OFFSETTING COLLECTIONS AND RECEIPTS FROM THE PUBLIC, AND NET OUTLAYS**

(In billions)

	Actual 2006	Estimate	
		2007	2008
Gross outlays .....	2,935.5	3,100.3	3,221.1
Offsetting collections and receipts from the public:			
User charges <sup>1</sup> .....	–197.8	–226.8	–241.2
Other .....	–82.2	–89.2	–78.1
Subtotal, offsetting collections and receipts from the public ...	–280.1	–316.0	–319.3
Net outlays .....	2,655.4	2,784.3	2,901.9

<sup>1</sup>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 .....	197.8	226.8	241.2
Receipts .....	3.5	3.5	3.4
Total, User charges .....	201.4	230.3	244.6

<sup>1</sup>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 often charges 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 \$201.4 billion in 2006, and are estimated to increase to \$230.3 billion in 2007 and to \$244.6 billion in 2008, growing to an estimated \$275.5 billion in 2012, 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 \$4.5 billion in 2008, growing to an estimated \$19.1 billion in 2012.

**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, and generally does not apply to 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 defini-

tions 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.<sup>2</sup>

**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

<sup>2</sup>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. When the Government is not acting in its capacity as sovereign and engages in a business-type transaction (i.e., leasing or selling goods, services, or resources), market price should be the basis for establishing the fee.<sup>3</sup>

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.

## II. TOTAL USER CHARGES

As shown in Table 18-2, total user charge collections (including those proposed in this Budget) are estimated to be \$244.6 billion in 2008, increasing to \$275.5 billion in 2012. User charge collections by the Postal Service

**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 2008 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. These regulatory charges are unlike user fees classified as offsets to outlays, which are normally for identifiable goods or services whose benefits primarily fall to the party paying the fee and for which alternatives may exist in the private sector or State and local sector.

The remaining user charges, an estimated \$241.2 billion in 2008, 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. Examples of these fees include immigration examination fees, U. S. customs processing fees, and nuclear regulatory fees.

An estimated \$141.8 billion of user charges for 2008 are credited directly to expenditure accounts, and are generally available for expenditure when they are collected, without further action by the Congress. An estimated \$99.4 billion of user charges for 2008 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."

and for Medicare premiums are the largest and are estimated to be more than half of total user charge collections in 2008.

<sup>3</sup>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 2006	Estimates					
		2007	2008	2009	2010	2011	2012
<b>Receipts</b>							
Judicial Branch: Filing fees, U.S. courts .....	221	144	172	157	153	159	164
Department of Agriculture: Agricultural quarantine inspection fees .....	418	455	494	502	509	517	524
Department of the Interior: Abandoned mine reclamation fund .....	303	301	295	270	275	282	286
Department of State: Immigration, passport, and consular fees .....	861	719	732	731	730	729	728
Corps of Engineers: Harbor maintenance fees .....	1,207	1,264	1,367	1,461	1,561	1,663	1,770
Other .....	538	567	357	304	306	309	312
Subtotal, receipts .....	3,548	3,450	3,417	3,425	3,534	3,659	3,784
<b>Offsetting Collections and Receipts from the Public</b>							
<b>Discretionary</b>							
Department of Agriculture: Food safety inspection and other charges .....	316	312	309	305	304	309	312
Department of Commerce: Patent and trademark, fees for weather services, and other charges .....	1,779	1,892	2,034	2,182	2,368	2,574	2,757
Department of Defense: Commissary and other charges .....	10,079	10,564	10,417	10,393	10,392	10,392	10,392
Department of Energy: Federal Energy Regulation Commission, power marketing, and other charges .....	982	1,131	1,345	1,323	1,319	1,349	1,361
Department of Health and Human Services: Food and Drug Administration, Centers for Medicare and Medicaid Services, and other charges .....	1,247	972	1,193	1,104	1,100	1,124	1,134
Department of Homeland Security: Border and Transportation Security and other charges .....	2,051	2,431	2,761	2,842	2,937	3,035	3,136
Department of the Interior: Minerals Management Service and other charges .....	736	721	843	826	811	848	850
Department of Justice: Charges for bankruptcy oversight and other charges .....	301	329	364	358	357	365	368
Department of State: Passport and other charges .....	948	1,308	1,576	1,622	1,670	1,719	1,769
Department of Transportation: FAA user fee proposal, pipeline safety, and other charges .....	188	105	252	8,422	8,908	9,344	9,766
Department of the Treasury: Sale of commemorative coins and other charges .....	1,606	1,992	1,948	1,916	1,909	1,954	1,970
Department of Veterans Affairs: Medical care and other charges .....	2,082	2,274	2,431	2,518	2,607	2,703	2,801
General Services Administration: Acquisition services fund and other charges .....	87	452	470	481	491	501	511
Social Security Administration: State supplemental fees, supplemental security income .....	116	119	135	133	132	135	137
Federal Communications Commission: Regulatory fees .....	383	374	397	391	389	398	402
Federal Trade Commission: Regulatory fees .....	133	153	165	162	162	165	167
Nuclear Regulatory Commission: Regulatory fees .....	624	641	765	756	756	774	783
Securities and Exchange Commission: Regulatory fees .....	1,904	1,379	1,147	1,332	1,520	1,740	1,742
All other agencies, discretionary user charges .....	-3,036	305	255	249	246	247	248
Subtotal, discretionary user charges .....	22,526	27,454	28,807	37,315	38,378	39,676	40,606
<b>Mandatory</b>							
Department of Agriculture: Crop insurance and other charges .....	1,941	1,829	2,648	2,457	2,405	2,444	2,374
Department of Defense: Commissary surcharge and other charges .....	1,036	742	784	791	770	703	515
Department of Energy: Proceeds from the sale of energy, nuclear waste disposal, and other charges .....	4,491	4,680	4,553	4,769	4,608	4,670	4,594
Department of Health and Human Services: Medicare Part B and Part D insurance premiums and other charges .....	47,250	54,956	59,578	64,404	69,320	74,660	80,728
Department of Homeland Security: Customs, immigration, and other charges .....	7,024	7,478	8,428	8,345	8,782	9,222	9,646
Department of the Interior: Recreation and other charges .....	6,156	4,778	5,148	5,654	5,497	5,383	5,866
Department of Justice: Federal Prison Commissary fees and other charges .....	435	516	549	561	575	588	602
Department of Labor: Insurance premiums to guaranty private pensions and other charges .....	3,160	3,756	3,607	6,575	7,532	7,943	8,561
Department of the Treasury: Bank regulation, and other charges .....	956	1,048	1,120	1,146	1,186	1,228	1,272
Department of Veterans Affairs: Veterans life insurance and other charges .....	2,468	2,499	2,207	2,291	2,258	2,230	2,239
Office of Personnel Management: Federal employee health and life insurance fees .....	11,164	11,560	12,207	13,001	13,947	14,991	15,978
Federal Deposit Insurance Corporation: Deposit insurance fees and other charges .....	252	865	2,526	5,318	6,946	8,105	6,330
National Credit Union Administration: Credit union share insurance and other charges .....	353	401	453	477	434	461	487
Postal Service: Fees for postal services .....	70,348	73,672	76,733	70,273	70,533	70,865	71,312
Tennessee Valley Authority: Proceeds from the sale of energy .....	9,051	9,136	9,410	8,428	8,708	8,987	9,354
<b>Undistributed Offsetting Receipts:</b>							
Department of Commerce: Digital television transition and public safety fund .....			11,800	2,058			
Department of the Interior: Arctic National Wildlife Refuge, lease bonuses .....				7,004	4	1,006	6
Executive Office of the President: Spectrum relocation receipts .....		6,850					
Federal Communications Commission: Auction receipts .....	111	6,900	50	100	100	100	
Outer Continental Shelf receipts and other collections .....	7,283	6,940	9,621	10,662	9,558	10,166	10,208
All other agencies, mandatory user charges .....	1,815	765	957	957	973	1,018	1,004
Subtotal, mandatory user charges .....	175,294	199,371	212,379	215,271	214,136	224,770	231,076
Subtotal, user charges that are offsetting collections and receipts from the public .....	197,820	226,825	241,186	252,586	252,514	264,446	271,682
<b>TOTAL, User charges</b> .....	<b>201,368</b>	<b>230,275</b>	<b>244,603</b>	<b>256,011</b>	<b>256,048</b>	<b>268,105</b>	<b>275,466</b>

### 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 \$4.5 billion in 2008, increasing to \$19.1 billion in 2012. These amounts are collections and receipts only. They do not include related spending.

#### A. Discretionary User Charge Proposals

##### 1. Offsetting collections

#### Department of Commerce: Minority Business Development Agency

*Conference fees.* The Budget proposed to give the Minority Business Development Agency (MBDA) the authority to collect and retain fees to offset the costs of conducting conferences. MBDA conducts the annual Minority Enterprise Development (MED) Week conference and estimated fees are less than \$500 thousand per year.

#### Department of Defense (DOD)

*Medical care enrollment fees and deductible.* The Budget gives DOD the authority to increase 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. The Budget also assumes that retail pharmacy co-payments for all military retirees will increase. None of these changes apply to active-duty members and their dependents. DOD will take into account the recommendations of the DOD Task Force on the Future of Military Health Care before final implementation.

The total 2008 savings for these proposals is estimated to be \$1,862 million.

#### Department of Health and Human Services

##### Food and Drug Administration (FDA)

*Generic drug review activities fee.* Generic drugs play an important role in reducing the cost of pharmaceuticals. The Budget proposes a new user fee to generate additional resources to support FDA's generic drug review activities. Similar to the purpose of FDA's current prescription drug user fees, the proposed generic drug user fee would be targeted towards improving review times and reducing the backlog of applications.

*Expiring user fees.* The Prescription Drug User Fee Act, the Medical Devices User Fee and Modernization Act, and the Mammography Quality Standards Act will expire on September 30, 2007. These laws authorize the FDA to assess and collect fees associated with the pre-market review of prescription drugs, medical devices, and activities related to ensuring mammography quality. The Administration supports reauthorizing the collection and spending of these fees.

##### Centers for Medicare and Medicaid Services

*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.

Table 18-3. USER FEE AND OTHER USER CHARGE PROPOSALS <sup>1</sup>

(Estimated collections in millions of dollars)

	2007	2008	2009	2010	2011	2012	2008-2012
<b>DISCRETIONARY:</b>							
<i>1. Offsetting collections</i>							
<b>Department of Commerce: Minority Business Development Agency</b>							
Conference fees .....		*	*	*	*	*	2
<b>Department of Defense</b>							
Medical care enrollment fees and deductible .....		1,862	2,322	2,815	3,424	4,061	14,484
<b>Department of Health and Human Services</b>							
Food and Drug Administration:							
Generic drug review activities fee .....		16	16	16	16	16	80
Prescription drug user fee .....		339	333	332	340	343	1,687
Medical devices user fee .....		48	47	47	48	49	239
Mammography standards user fee .....		18	18	18	18	18	90
Centers for Medicare and Medicaid Services: Survey and certification user fee .....		35	34	34	35	35	173
<b>Department of Transportation</b>							
Federal Aviation Administration: User fee proposal .....			8,173	8,660	9,092	9,511	35,436
<b>Federal Election Commission</b>							
Registration fees .....		*	*	*	*	*	1
<i>2. Offsetting receipts</i>							
<b>Department of Homeland Security: U.S. Citizenship and Immigration Services</b>							
Systematic alien verification for entitlements program .....		3	3	3	3	3	15
<b>Department of Housing and Urban Development</b>							
Office of Federal Housing Enterprise Oversight .....		-66	-65	-65	-66	-67	-329
<b>Department of the Interior</b>							
Repeal Energy Act fee prohibition .....		21	21	21	21	21	105
Subtotal, discretionary user charge proposals .....		2,277	10,903	11,882	12,932	13,991	51,983
<b>MANDATORY:</b>							
<i>1. Offsetting collections</i>							
<b>Department of Labor</b>							
Pension Benefit Guaranty Corporation premiums .....			1,390	1,387	1,400	1,295	5,472
<b>Federal Housing Enterprise Regulator</b>							
Government-Sponsored Enterprises regulatory fee .....		101	105	105	107	109	527
<b>Federal Housing Finance Board</b>							
Federal Home Loan Bank fees .....		-35	-39	-40	-41	-42	-197
<i>2. Offsetting receipts</i>							
<b>Department of Agriculture</b>							
Food Safety and Inspection Service user fees .....		96	98	100	102	104	500
Grain, Inspection, Packers, and Stockyards Administration user fees .....		22	22	23	23	24	115
Animal and Plant Health Inspection Service user fees .....		9	13	13	14	14	63
Federal crop insurance fees .....			15	15	15	15	60
Forest county safety net payments .....		467	264	180	137		1,048
<b>Department of Defense</b>							
National defense stockpile asset sales: Authorization for additional sales .....		69	145	198	145	25	582
<b>Department of Health and Human Services</b>							
Food and Drug Administration: Re-inspection fees and export certification fees .....		27	28	28	29	30	142
Centers for Medicare and Medicaid Services: Additional Medicare premiums .....		403	804	1,116	1,432	1,792	5,547
<b>Department of Housing and Urban Development</b>							
Ginnie Mae premium increase .....		46	46	46	46	46	230
Government-Sponsored Enterprises oversight fee .....		6	6	6	6	6	30
<b>Department of the Interior</b>							
Amend Bureau of Land Management Federal land sale authority .....		5	10	14	53	53	135
Require upfront payment of coal bonus bid receipts .....		2	121	115	54	134	426
Arctic National Wildlife Refuge lease bonuses:							
Collections for payment to Alaska .....			3,502	2	503	3	4,010
Collections deposited in the Treasury .....			3,502	2	503	3	4,010
<b>Department of Labor</b>							
Foreign labor certification fees .....		65	65	65	65	65	325
<b>Department of Veterans Affairs</b>							
Pharmacy co-pay increase .....		311	304	306	307	342	1,570
Income-based medical care enrollment fee .....			138	134	129	125	526
Third-party insurance co-payment offset .....		44	44	44	43	43	218
<b>Corps of Engineers—Civil Works</b>							
Additional recreation fees .....		7	10	13	16	19	65



**Table 18-3. USER FEE AND OTHER USER CHARGE PROPOSALS<sup>1</sup>—Continued**

(Estimated collections in millions of dollars)

	2007	2008	2009	2010	2011	2012	2008–2012
<b>Environmental Protection Agency</b>							
Pesticide user fees .....		66	57	60	66	57	306
Pre-manufacture notice user fees .....		4	8	8	8	8	36
<b>Commodity Futures Trading Commission</b>							
Transaction fees .....		86	89	92	95	99	461
<b>Federal Communications Commission</b>							
Spectrum license fee authority .....		50	150	300	300	400	1,200
Extend spectrum auction authority .....						200	200
Prospective ancillary terrestrial component spectrum auctions .....		150	150	150	150	150	750
Domestic satellite spectrum auctions .....	130	252	105	100	100	75	632
Subtotal, mandatory user charge proposals .....	130	2,253	11,152	4,582	5,807	5,194	28,989
<b>GOVERNMENTAL RECEIPTS</b>							
<b>Department of Transportation</b>							
Federal Aviation Administration: Aviation overflight fees .....			-56	-58	-60	-62	-236
<b>Total, user charge proposals</b> .....	<b>130</b>	<b>4,530</b>	<b>21,999</b>	<b>16,406</b>	<b>18,679</b>	<b>19,123</b>	<b>80,736</b>

<sup>1</sup> A negative sign indicates a decrease in collections.  
\* \$500 thousand or less

### Department of Transportation: Federal Aviation Administration (FAA)

*User fee proposal.* The Budget includes a reauthorization proposal that would make the Federal Aviation Administration's financing system more cost-based. The FAA's current excise tax system, which generated \$10.6 billion in 2006, largely based on taxes on the price of airline tickets, does not have a direct relationship between the taxes paid by users and the air traffic control services provided by the FAA. Under its reauthorization proposal, FAA would collect user fees from commercial aviation operators for air traffic control services. Implementing user fees for services provided should create incentives to make the system more efficient and responsive to user needs. FAA would have the authority to collect the user fees that directly offset the cost of its operations; expenditure of the proceeds from these fees would be subject to the appropriations process. The Budget assumes FAA will implement its new financing system starting in 2009, and estimates FAA will collect \$8 billion in user fees during the first year.

### Federal Election Commission

*Registration fees.* The Federal Election Commission hosts public conferences on subjects related to campaign finance. The Administration proposes to grant the FEC authority to collect registration fees from attendees to cover the cost of these events.

### 2. Offsetting receipts

### Department of Homeland Security: U.S. Citizenship and Immigration Services (USCIS)

*Systematic alien verification for entitlements program.* The Budget requests authority for the Secretary of the Department of Homeland Security (DHS) to deposit fees

collected from the Systematic Alien Verification for Entitlements (SAVE) Program into the USCIS immigration examinations fee account. This program is an inter-governmental information-sharing initiative that aids organizations in determining an applicant's/recipient's immigration status, and thereby ensure that only entitled applicants/recipients receive Federal, State, or local public benefits as required by the Immigration Reform and Control Act. The proposed language will clarify DHS authority to collect these fees and provide them the authority to deposit those fees in their mandatory fee account.

### Department of Housing and Urban Development

*Office of Federal Housing Enterprise Oversight.* This proposal is discussed below in the section on the Federal Housing Enterprise Regulator.

### Department of the Interior

*Repeal Energy Act fee prohibition.* A last-minute addition to the 2005 Energy Policy Act prohibited the Bureau of Land Management from implementing new user fees for oil and gas permit processing and instead diverted existing rental receipts to make up for the lost program funding. The Budget proposes to repeal these changes and substitute new user fees for the mandatory funding provided by the Act. The proposal would also repeal a mandatory geothermal program fund drawn from Federal geothermal royalties and return to the traditional 50/50 Federal-State revenue sharing arrangement for geothermal revenues. The proposed fees are expected to generate at least \$20 million per year beginning in 2008, thereby reducing the cost to taxpayers for operating these programs. Additional savings will be generated by discontinuing the Act's mandatory spending provisions related to geothermal receipts.

## B. Mandatory User Charge Proposals

### 1. Offsetting collections

#### Department of Labor

*Pension Benefit Guaranty Corporation (PBGC) premiums.* The Budget re-proposes increases to the premiums paid to the PBGC for single-employer defined benefit pension insurance. Despite improvements in the recently enacted Pension Protection Act, further premium increases are needed to reduce PBGC's \$19 billion deficit.

#### Federal Housing Enterprise Regulator

*Government-Sponsored Enterprises (GSE) regulatory fee.* 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 in the Department of Housing and Development and the Federal Housing Finance Board would instead be collected by a new housing GSE safety and soundness regulator. For additional information, see the "Credit and Insurance" chapter in this volume.

#### Federal Housing Finance Board

*Federal Home Loan Bank fees.* This proposal is discussed above in the section on the Federal Housing Enterprise Regulator.

### 2. Offsetting receipts

#### Department of Agriculture

*Food Safety and Inspection Service (FSIS) user fees.* This Budget proposes two new user fees, a licensing fee and a performance fee. These two fees are different from those proposed in recent budgets and do not try to completely offset a portion of the Food Safety and Inspection Services operational expenses. The recommended fees, estimated to be \$96 million in the first year, include:

- \$92 million for a licensing fee scaled to the size of the operation, and
- \$4 million for a performance fee. Plants that have resampling and retesting due to positive samples, recalls, or are linked to outbreaks would pay a fee to FSIS for each incident.

*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.

*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.

*Forest county safety net payments.* The Budget includes a legislative proposal that authorizes the Secretary of Agriculture to dispose of certain Forest Service lands, up to \$800 million, identified in National Forest plans as suitable for exchange since they are isolated or inefficient to manage. Along with additional proceeds, these receipts will finance payments to the most affected areas and for national forest land acquisition in States where parcels are sold. For the 2007 payment (to be made in 2008), the Administration will continue to work with Congress to identify mutually agreeable offsets.

#### 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 an estimated \$69 million in 2008. 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.

*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.

##### Centers for Medicare and Medicaid Services

*Additional Medicare premiums.* Medicare beneficiaries share in the costs of their health services through premiums, deductibles, and co-insurance. The Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (MMA) began to limit the growth in subsidies for certain higher-income beneficiaries. Beneficiaries who are most able to contribute to the costs of their coverage have more responsibility and ownership over their health care utilization and costs.

To help improve Medicare's long-term sustainability, the Budget proposes to broaden the application of reduced subsidies for certain higher-income beneficiaries.

### **Department of Housing and Urban Development (HUD)**

*Ginnie Mae premium increase.* This proposal will create an upfront premium of 6 basis points on new mortgage-backed securities that will be charged to security issuers. This will generate receipts to cover the total cost of administering the Government National Mortgage Association (Ginnie Mae) and promote oversight of such spending.

*Government-Sponsored Enterprises (GSE) oversight fee.* Upon enactment of the Administration's proposal for a strengthened regulator for GSEs, 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.

### **Department of the Interior**

*Amend Bureau of Land Management (BLM) Federal land sale authority.* The Administration will propose legislation to amend BLM's land sale authority under the Federal Land Transaction Facilitation Act (FLFTA) 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 FLFTA. 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.

*Require upfront payment of coal bonus bid receipts.* The Budget proposes to amend the Mineral Leasing Act to change the current practice of allowing bonus bid payments for coal lease sales to be made over a five-year period, instead requiring the full payment to be made in the sale year. This proposal would increase near-term revenues, but would reduce revenues in later years when deferred payments under the current system would otherwise be collected.

*Arctic National Wildlife Refuge lease bonuses.* 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 2009 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 2008 Budget re-proposes legislation to establish a cost-based user fee for new applications under the permanent foreign 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.

### **Department of Veterans Affairs**

*Medical care fees.* The President's Budget includes legislation to implement new or higher fees for non-disabled higher-income veterans (PL 7/8 veterans). These veterans will pay higher drug co-pays (from \$8 to \$15) and new income-based annual enrollment fees that start at \$250 for those with household incomes of \$50,000 and rise to \$750 for those with incomes of \$100,000 or greater. 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 health insurance. These proposals will result in an additional \$355 million in estimated receipts for 2008.

### **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. The Corps would implement user fees and private/public partnerships 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 (EPA)**

*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 2008. 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 initiated this new Registration Review program in 2007. 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.

### **Commodity Futures Trading Commission (CFTC)**

*Transaction fees.* The CFTC is the only Federal financial regulator that does not derive its funding from the specialized entities it regulates. The Administration will propose legislation to collect a new transaction fee on commodity futures and option contracts traded on approved exchanges. The fees would be set at a level to equal the costs to the taxpayer of funding CFTC's Market Oversight and Clearing and Intermediary Oversight functions, an estimated \$86 million in 2008. Such fees are already imposed on futures exchanges to fund the programs of the futures industry's self-regulatory organization, and will help to offset the deficit impact of general taxpayer funding of the CFTC's activities.

### **Federal Communications Commission**

*Spectrum license fee authority.* To continue to promote efficient spectrum use, the Administration proposes legislation to provide the Federal Communications Commission (FCC) with new authority to use other economic mechanisms, such as fees, as a spectrum management tool. The Commission would be authorized to set user fees on unauctioned spectrum licenses based on public-interest and spectrum-management principles. Fees would be phased in over time as part of an ongoing rulemaking process to determine the appropriate application and level for fees. Fee collections are proposed to begin in 2008 and are estimated to total more than \$3.6 billion through 2017.

*Extend spectrum auction authority.* The Administration proposes legislation to extend indefinitely the authority of the FCC to auction spectrum licenses, which expires on September 30, 2011. The additional receipts associated with this permanent extension are estimated to total \$1.2 billion through 2017.

*Prospective ancillary terrestrial component spectrum auctions.* The Administration proposes legislation to bring greater competition to the assignment of the land-based component of hybrid terrestrial-satellite communications networks, such as the Ancillary Terrestrial Component to Mobile Satellite Services, subject to technical feasibility as determined by the FCC. The use of auctions to assign the land-based component for any future satellite licenses for these hybrid networks will help to ensure that the radio spectrum is assigned efficiently and effectively. The additional receipts associated with this policy are estimated to total \$1.5 billion through 2017.

*Domestic satellite spectrum auctions.* The Administration proposes legislation to ensure that spectrum licenses for predominantly domestic satellite services are assigned efficiently and effectively through competitive bidding. Services such as Direct Broadcast Satellite and Satellite Digital Audio Radio Services were assigned by auction prior to a 2005 court decision that questioned this practice on technical grounds. By clarifying through legislation that auctions of licenses for these domestic satellite services are authorized, prior policy of the FCC will be restored. The additional receipts associated with this policy are estimated to total \$690 million through 2017.

### **C. User Charge Proposals that are Governmental Receipts**

*Federal Aviation Administration (FAA): Aviation overflight fees.* This proposal is part of the proposal discussed above for the FAA user fees.

## **OTHER OFFSETTING COLLECTIONS AND RECEIPTS**

Table 18-4 shows the distribution of user charges and other offsetting collections and receipts from the public 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 \$319.3

billion in 2008. Of these, an estimated \$169.9 billion are offsetting collections credited to expenditure accounts and an estimated \$149.4 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 offsetting receipts from the public (as summarized in Table 18–4) and also payments from one part of the Government to an-

other, called intragovernmental transactions. These receipts are offset (deducted) from outlays in the Federal budget. In total, offsetting receipts are estimated to be \$737.0 billion in 2008: \$587.6 billion are intragovernmental transactions; and \$149.4 billion are from the public. The \$149.4 billion in offsetting receipts from the public consist of proprietary receipts from the public (\$129.9 billion) and offsetting governmental receipts (\$19.5 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 billions of dollars)

	Actual 2006	Estimate	
		2007	2008
<b>Offsetting collections (credited to expenditure accounts):</b>			
User charges:			
Postal service stamps and other postal fees (off-budget) .....	70.3	73.7	76.7
Defense Commissary Agency .....	5.5	5.4	5.4
Employee contributions for employees and retired employees health benefits funds .....	9.1	9.4	10.0
Sale of energy:			
Tennessee Valley Authority .....	9.1	9.1	9.4
Bonneville Power Administration .....	3.3	3.3	3.3
All other user charges .....	29.6	34.5	36.9
Subtotal, user charges .....	126.8	135.5	141.8
Other collections credited to expenditure accounts:			
Commodity Credit Corporation fund .....	10.2	13.7	13.2
Supplemental security income (collections from the States) .....	4.2	4.4	4.6
Other collections .....	14.8	10.5	10.4
Subtotal, other collections .....	29.1	28.6	28.1
Subtotal, offsetting collections .....	156.0	164.1	169.9
<b>Offsetting receipts (deposited in receipt accounts):</b>			
User charges:			
Medicare premiums .....	45.1	52.8	57.3
Outer Continental Shelf rents, bonuses, and royalties .....	7.3	6.8	9.2
All other user charges .....	18.6	31.7	32.9
Subtotal, user charges deposited in receipt accounts .....	71.0	91.3	99.4
Other collections deposited in receipt accounts:			
Military assistance program sales .....	14.2	15.1	13.1
Interest income .....	14.7	16.1	16.2
All other collections deposited in receipt accounts .....	24.2	29.4	20.7
Subtotal, other collections deposited in receipt accounts .....	53.1	60.5	49.9
Subtotal, offsetting receipts .....	124.1	151.8	149.4
<b>Total, offsetting collections and receipts from the public .....</b>	<b>280.1</b>	<b>316.0</b>	<b>319.3</b>
<b>Total, offsetting collections and receipts excluding off-budget .....</b>	<b>209.7</b>	<b>242.3</b>	<b>242.5</b>
<b>ADDENDUM:</b>			
User charges that are offsetting collections and receipts <sup>1</sup> .....	197.8	226.8	241.2
Other offsetting collections and receipts from the public .....	82.2	89.2	78.1
<b>Total, offsetting collections and receipts from the public .....</b>	<b>280.1</b>	<b>316.0</b>	<b>319.3</b>

<sup>1</sup> 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	2006 Actual	Estimate					
		2007	2008	2009	2010	2011	2012
<b>INTRAGOVERNMENTAL TRANSACTIONS</b>							
<b>On-budget receipts:</b>							
Federal intrafund transactions:							
Distributed by agency:							
Interest from the Federal Financing Bank .....	391	765	1,023	1,077	1,174	1,272	1,450
Interest on Government capital in enterprises .....	1,208	1,716	1,654	846	838	850	862
Interest received by retirement and health benefits funds .....	198	169	176	183	198	215	235
General fund payments to retirement and health benefits funds:							
Employees health benefits fund .....		5,400	5,400	5,400	5,500	5,500	5,600
DoD retiree health care fund .....	20,391	19,415	21,185	23,101	25,196	27,461	29,887
Miscellaneous Federal retirement funds .....	285	345	362	427	524	487	489
Other .....	1,998	5,723	4,291	4,741	4,726	5,175	5,694
Undistributed by agency:							
Employing agency contributions:							
DoD retiree health care fund .....	11,138	11,550	11,212	12,216	12,993	13,897	14,691
Total Federal intrafunds .....	35,609	45,083	45,303	47,991	51,149	54,857	58,908
Trust intrafund transactions:							
Distributed by agency:							
Payments to railroad retirement .....	4,793	5,211	5,298	5,392	5,710	6,163	5,959
Total trust intrafunds .....	4,793	5,211	5,298	5,392	5,710	6,163	5,959
Total intrafund transactions .....	40,402	50,294	50,601	53,383	56,859	61,020	64,867
Interfund transactions:							
Distributed by agency:							
Federal fund payments to trust funds:							
Contributions to insurance programs:							
Military retirement fund .....	23,180	26,048	27,025	28,039	29,090	30,181	31,313
Supplementary medical insurance .....	162,602	175,657	187,749	197,816	212,353	231,110	246,821
Proposed Legislation (non-PAYGO) .....			-1,649	-3,594	-5,409	-7,063	-8,916
Hospital insurance .....	10,973	11,572	13,248	14,410	16,037	17,775	19,699
Railroad social security equivalent fund .....	129	132	144	159	168	186	205
Rail industry pension fund .....	337	325	339	355	370	386	401
Civilian supplementary retirement contributions .....	28,430	32,388	33,831	35,470	37,199	38,969	41,180
Unemployment insurance .....	828	830	807	806	812	800	781
Other contributions .....	782	850	882	831	898	777	767
Subtotal .....	227,261	247,802	262,376	274,292	291,518	313,121	332,251
Miscellaneous payments .....	1,870	1,762	1,775	1,751	1,731	1,749	1,758
Proposed Legislation (non-PAYGO) .....			2,752				
Subtotal .....	229,131	249,564	266,903	276,043	293,249	314,870	334,009
Trust fund payments to Federal funds:							
Quinquennial adjustment for military service credits .....	350						
Other .....	1,757	24,804	1,840	1,894	1,946	2,000	2,201
Proposed Legislation (non-PAYGO) .....			2,315	-437	-432	-424	-424
Subtotal .....	2,107	24,804	4,155	1,457	1,514	1,576	1,777
Total interfunds distributed by agency .....	231,238	274,368	271,058	277,500	294,763	316,446	335,786
Undistributed by agency:							
Employer share, employee retirement (on-budget):							
Civil service retirement and disability insurance .....	13,819	14,072	15,714	16,623	18,141	19,723	21,342
Proposed Legislation (non-PAYGO) .....			2	8	15	23	31
CSRDI from Postal Service .....	4,429	3,382	3,596	3,817	4,063	4,327	4,609
Hospital insurance (contribution as employer) <sup>1</sup> .....	2,722	2,839	2,965	3,053	3,180	3,344	3,439
Postal employer contributions to FHI .....	682	694	720	752	788	827	868
Military retirement fund .....	16,240	16,115	17,249	18,356	19,046	19,806	20,430

Table 18-5. OFFSETTING RECEIPTS BY TYPE—Continued

(In millions of dollars)

Source	2006 Actual	Estimate					
		2007	2008	2009	2010	2011	2012
Other Federal employees retirement .....	201	193	195	198	200	202	204
Total employer share, employee retirement (on-budget) .....	38,093	37,295	40,441	42,807	45,433	48,252	50,923
Interest received by on-budget trust funds .....	71,574	75,067	77,710	80,363	83,658	86,270	87,640
Proposed Legislation (non-PAYGO) .....			117	369	779	1,339	2,085
Total interfund transactions undistributed by agency .....	109,667	112,362	118,268	123,539	129,870	135,861	140,648
Total interfund transactions .....	340,905	386,730	389,326	401,039	424,633	452,307	476,434
Total on-budget receipts .....	381,307	437,024	439,927	454,422	481,492	513,327	541,301
<b>Off-budget receipts:</b>							
Trust intrafund transactions:							
Distributed by agency:							
Interfund transactions:							
Distributed by agency:							
Federal fund payments to trust funds:							
Old-age, survivors, and disability insurance .....	22,056	19,358	19,962	22,034	24,227	27,110	30,069
Undistributed by agency:							
Employer share, employee retirement (off-budget) .....	11,625	12,289	13,108	13,848	14,739	15,788	16,560
Interest received by off-budget trust funds .....	97,722	106,249	114,618	124,802	136,492	149,278	162,901
Proposed Legislation (non-PAYGO) .....							-775
Total off-budget receipts: .....	131,403	137,896	147,688	160,684	175,458	192,176	208,755
<b>Total intragovernmental transactions .....</b>	<b>512,710</b>	<b>574,920</b>	<b>587,615</b>	<b>615,106</b>	<b>656,950</b>	<b>705,503</b>	<b>750,056</b>
<b>PROPRIETARY RECEIPTS FROM THE PUBLIC</b>							
<b>Distributed by agency:</b>							
Interest:							
Interest on foreign loans and deferred foreign collections .....	285	210	210	210	210	210	210
Interest on deposits in tax and loan accounts .....	924	1,022	871	834	797	769	767
Proposed Legislation (non-PAYGO) .....			10	10	10	10	10
Other interest (domestic—civil) <sup>2</sup> .....	11,264	12,494	13,632	14,681	16,041	17,554	19,047
Total interest .....	12,473	13,726	14,723	15,735	17,058	18,543	20,034
Dividends and other earnings .....	2,177	2,382	1,446	1,490	1,511	1,486	1,464
Royalties and rents .....	4,337	3,955	4,271	4,452	4,384	4,392	4,671
Proposed Legislation (PAYGO) .....			-44	192	177	58	216
Sale of products:							
Sale of timber and other natural land products .....	393	272	279	288	296	305	314
Proposed Legislation (PAYGO) .....			67	64	60	57	
Sale of minerals and mineral products .....	671	74	39	37	36	35	36
Sale of power and other utilities .....	725	705	674	644	660	628	630
Proposed Legislation (PAYGO) .....			17	17	17	17	17
Other .....	102	99	115	112	99	119	115
Proposed Legislation (PAYGO) .....			14	14	14	14	14
Total sale of products .....	1,891	1,150	1,205	1,176	1,182	1,175	1,126
Fees and other charges for services and special benefits:							
Medicare premiums and other charges (trust funds) .....	45,108	52,785	57,202	61,923	66,864	72,138	78,222
Proposed Legislation (PAYGO) .....			78	82	-43	-78	-95
Nuclear waste disposal revenues .....	752	760	770	771	773	774	775
Veterans life insurance (trust funds) .....	154	141	128	116	104	92	82
Other <sup>2</sup> .....	7,908	12,002	12,060	12,672	13,338	14,130	15,025
Proposed Legislation (non-PAYGO) .....			21	21	21	21	21
Proposed Legislation (PAYGO) .....			762	1,091	1,306	1,561	1,900
Total fees and other charges .....	53,922	65,688	71,021	76,676	82,363	88,638	95,930
Sale of Government property:							
Sale of land and other real property <sup>2</sup> .....	984	191	229	197	195	160	160
Proposed Legislation (PAYGO) .....			376	177	102	99	19
Military assistance program sales (trust funds) .....	14,233	15,053	13,054	11,446	11,651	11,861	12,074

Table 18-5. OFFSETTING RECEIPTS BY TYPE—Continued

(In millions of dollars)

Source	2006 Actual	Estimate					
		2007	2008	2009	2010	2011	2012
Other .....	214	147	164	130	106	99	47
Proposed Legislation (PAYGO) .....			69	145	198	145	25
<b>Total sale of Government property .....</b>	<b>15,431</b>	<b>15,391</b>	<b>13,892</b>	<b>12,095</b>	<b>12,252</b>	<b>12,364</b>	<b>12,325</b>
<b>Realization upon loans and investments:</b>							
Negative subsidies and downward reestimates .....	8,600	11,752	713	629	611	609	534
Proposed Legislation (non-PAYGO) .....			-21	-21	-21	-21	-21
Proposed Legislation (PAYGO) .....			2,859	46	46	46	46
Repayment of loans to foreign nations .....	328						
Other .....	475	70	67	80	80	80	80
<b>Total realization upon loans and investments .....</b>	<b>9,403</b>	<b>11,822</b>	<b>3,618</b>	<b>734</b>	<b>716</b>	<b>714</b>	<b>639</b>
<b>Recoveries and refunds<sup>2</sup> .....</b>	<b>8,169</b>	<b>8,782</b>	<b>8,562</b>	<b>8,935</b>	<b>9,385</b>	<b>9,131</b>	<b>9,276</b>
Proposed Legislation (non-PAYGO) .....				58	122	126	130
Proposed Legislation (PAYGO) .....			2	492	507	373	379
Miscellaneous receipt accounts <sup>2</sup> .....	2,980	2,008	1,949	1,961	1,972	1,983	1,994
Proposed Legislation (PAYGO) .....			14	14	14	14	14
<b>Total proprietary receipts from the public distributed by agency .....</b>	<b>110,783</b>	<b>124,904</b>	<b>120,659</b>	<b>124,010</b>	<b>131,643</b>	<b>138,997</b>	<b>148,198</b>
<b>Undistributed by agency:</b>							
Other interest: Interest received from Outer Continental Shelf escrow account .....	2						
Rents, bonuses, and royalties:							
Outer Continental Shelf rents and bonuses .....	967	662	2,404	1,169	875	532	474
Outer Continental Shelf royalties .....	6,316	6,148	6,740	8,759	8,087	9,035	8,860
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 .....		6,850					
<b>Total proprietary receipts from the public undistributed by agency .....</b>	<b>7,285</b>	<b>13,660</b>	<b>9,194</b>	<b>17,305</b>	<b>9,016</b>	<b>10,623</b>	<b>9,390</b>
<b>Total proprietary receipts from the public .....</b>	<b>118,068</b>	<b>138,564</b>	<b>129,853</b>	<b>141,315</b>	<b>140,659</b>	<b>149,620</b>	<b>157,588</b>
<b>OFFSETTING GOVERNMENTAL RECEIPTS</b>							
<b>Distributed by agency:</b>							
Regulatory fees .....	5,759	6,108	7,032	7,235	7,527	7,866	8,158
Proposed Legislation (non-PAYGO) .....			-63	-62	-62	-63	-64
Proposed Legislation (PAYGO) .....			65	65	65	65	65
Other .....	159	143	144	144	145	124	125
Proposed Legislation (PAYGO) .....			27	28	28	29	30
<b>Undistributed by agency:</b>							
Spectrum auction proceeds .....	111	6,900	11,850	2,158	100	100	
Proposed Legislation (PAYGO) .....		130	452	405	550	550	825
<b>Total offsetting governmental receipts .....</b>	<b>6,029</b>	<b>13,281</b>	<b>19,507</b>	<b>9,973</b>	<b>8,353</b>	<b>8,671</b>	<b>9,139</b>
<b>Total offsetting receipts .....</b>	<b>636,807</b>	<b>726,765</b>	<b>736,975</b>	<b>766,394</b>	<b>805,962</b>	<b>863,794</b>	<b>916,783</b>

<sup>1</sup> Includes provision for covered Federal civilian employees and military personnel.<sup>2</sup> 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. In general, the tax expenditure estimates presented in this chapter are 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. An alternative approach would be to pattern the tax expenditure estimates on a comprehensive consumption tax. Which approach is used is perhaps the most important factor determining what is included as a tax expenditure. For example, because a consumption tax does not tax the return to saving or investment, using a comprehensive consumption tax as the normative baseline for determining tax expenditures would exclude current tax exemptions related to retirement and education saving accounts. Similarly, business provisions that provide accelerated depreciation or expensing of investment would also be excluded as tax expenditures because investment is generally deducted immediately under a comprehensive consumption tax.

The choice of the baseline—a comprehensive income or a comprehensive consumption tax—is arbitrary when viewed from the perspective of the current so-called income tax system, which includes elements of both income and consumption taxes. According to Treasury Department analysis, roughly 35 percent of household financial assets receive consumption tax treatment because assets are held in tax-preferred accounts such as individual retirement accounts (IRAs), defined-contribution retirement plans (401(k) type plans), defined-benefit pension plans, and tax-preferred annuities and various life insurance products. The balance of household financial assets reflecting most other saving vehicles receive income tax treatment.

### 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, 2006. Expired or repealed provisions are not listed if their revenue effects result only from taxpayer activ-

ity occurring before fiscal year 2006. 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

The ambiguities in the tax expenditure concept are reviewed in greater detail in Appendix A. This review focuses on defining tax expenditures relative to a comprehensive income tax baseline and a consumption tax baseline, and defining negative tax expenditures, i.e., provisions of current law that over-tax certain items or activities.

The tax expenditure estimates presented below differ from a comprehensive income tax in a number of other important respects. While under a comprehensive income tax all income is taxed once, the U.S. income tax system generally taxes corporate income twice, first at the corporate level through the corporate income tax and then again when the income is received by investors as dividends or capital gains. This “double tax” is accounted for in some of the tax expenditure estimates, such as those related to retirement savings, but not in the corporate tax expenditures. Indeed, the tax expenditure estimates, in large part, view the individual and corporation income taxes separately, rather than as an integrated system as appropriate under comprehensive income tax principles. Other areas of divergence from a comprehensive income tax are detailed below.

An important assumption underlying each tax expenditure estimate reported below is that other parts of the tax code remain unchanged. The estimates would be different if 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.

Tax expenditures relating to the individual and corporate income taxes are estimated for fiscal years 2006–2012 using two methods of accounting: current revenue effects and present value effects. The present value approach provides estimates of the revenue effects for tax expenditures that generally involve deferrals of tax payments into the future.

A discussion of performance measures and economic effects related to the assessment of the effect of tax expenditures on the achievement of program performance goals is presented in Appendix B. This section is a complement to the Government-wide performance plan required by the Government Performance and Results Act of 1993.

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 2006–2012 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.

Two baseline concepts—the normal tax baseline and the reference tax law baseline—are used to identify and estimate tax expenditures.<sup>1</sup> 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 2008–2012 revenue effect. The first column provides the number of the provision in order to cross reference this table to Tables 19–1 and 19–2 as well as to the descriptions below. Outlay Equivalent Estimates of Income Tax Expenditures, which were included in prior volumes of *Analytical Perspectives*, are no longer included in this chapter.<sup>2</sup>

### 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.

<sup>1</sup>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.

<sup>2</sup>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							
	2006	2007	2008	2009	2010	2011	2012	2008–12
<b>National Defense</b>								
1 Exclusion of benefits and allowances to armed forces personnel .....	3,100	3,220	3,350	3,480	3,620	3,780	3,930	18,160
<b>International affairs:</b>								
2 Exclusion of income earned abroad by U.S. citizens .....	2,500	2,630	2,760	2,900	3,050	3,200	3,360	15,270
3 Exclusion of certain allowances for Federal employees abroad .....	800	840	880	920	970	1,020	1,070	4,860
4 Extraterritorial income exclusion .....	4,400	1,630	.....	.....	.....	.....	.....	.....
5 Inventory property sales source rules exception .....	1,730	1,890	2,120	2,330	2,510	2,704	2,913	12,577
6 Deferral of income from controlled foreign corporations (normal tax method) .....	11,160	11,940	12,770	13,650	14,600	15,620	16,710	73,350
7 Deferred taxes for financial firms on certain income earned overseas .....	2,260	2,370	2,490	1,060	.....	.....	.....	3,550
<b>General science, space, and technology:</b>								
8 Expensing of research and experimentation expenditures (normal tax method) .....	7,920	5,680	5,280	4,060	5,030	6,230	6,000	26,600
9 Credit for increasing research activities .....	2,180	10,320	4,960	2,100	920	360	70	8,410
<b>Energy:</b>								
10 Expensing of exploration and development costs, fuels .....	680	860	840	710	600	450	310	2,910
11 Excess of percentage over cost depletion, fuels .....	760	790	790	790	780	760	740	3,860
12 Alternative fuel production credit .....	2,980	2,370	780	10	10	.....	.....	800
13 Exception from passive loss limitation for working interests in oil and gas properties .....	30	30	30	30	30	30	30	150
14 Capital gains treatment of royalties on coal .....	160	170	170	170	190	180	130	840
15 Exclusion of interest on energy facility bonds .....	40	40	50	50	50	50	50	250
16 New technology credit .....	510	690	960	1,120	1,150	1,150	1,150	5,530
17 Alcohol fuel credits <sup>1</sup> .....	50	50	60	70	80	30	.....	240
18 Tax credit and deduction for clean-fuel burning vehicles .....	110	260	150	130	-20	-50	-60	150
19 Exclusion of utility conservation subsidies .....	110	110	110	110	110	110	100	540
20 Credit for holding clean renewable energy bonds .....	20	60	80	100	100	100	100	480
21 Deferral of gain from dispositions of transmission property to implement FERC restructuring policy ...	620	530	230	-100	-360	-510	-540	-1,280
22 Credit for investment in clean coal facilities .....	.....	30	50	80	130	180	250	690
23 Temporary 50% expensing for equipment used in the refining of liquid fuels .....	10	30	120	240	260	180	-50	750
24 Natural gas distribution pipelines treated as 15-year property .....	20	50	90	120	150	150	120	630
25 Amortize all geological and geophysical expenditures over 2 years .....	10	60	90	70	40	10	10	220
26 Allowance of deduction for certain energy efficient commercial building property .....	80	190	170	90	30	-10	-10	270
27 Credit for construction of new energy efficient homes .....	10	20	30	20	10	.....	.....	60
28 Credit for energy efficiency improvements to existing homes .....	230	380	150	.....	.....	.....	.....	150
29 Credit for energy efficient appliances .....	120	80	.....	.....	.....	.....	.....	.....
30 30% credit for residential purchases/installations of solar and fuel cells .....	10	10	10	.....	.....	.....	.....	10
31 Credit for business installation of qualified fuel cells and stationary microturbine power plants .....	80	90	130	50	-10	-10	-10	150
32 Partial expensing for advanced mine safety equipment .....	.....	10	20	.....	.....	.....	.....	20
<b>Natural resources and environment:</b>								
33 Expensing of exploration and development costs, nonfuel minerals .....	10	10	10	10	10	10	10	50
34 Excess of percentage over cost depletion, nonfuel minerals .....	450	480	490	510	530	550	570	2,650
35 Exclusion of interest on bonds for water, sewage, and hazardous waste facilities .....	510	580	600	630	640	670	680	3,220
36 Capital gains treatment of certain timber income .....	160	170	170	170	190	180	130	840
37 Expensing of multiperiod timber growing costs .....	290	310	320	330	350	360	370	1,730
38 Tax incentives for preservation of historic structures .....	390	400	430	440	470	490	520	2,350
39 Expensing of capital costs with respect to complying with EPA sulfur regulations .....	10	10	30	50	30	.....	.....	110
40 Exclusion of gain or loss on sale or exchange of certain brownfield sites .....	.....	10	30	40	40	40	30	180
<b>Agriculture:</b>								
41 Expensing of certain capital outlays .....	130	130	130	140	140	150	150	710
42 Expensing of certain multiperiod production costs .....	70	70	80	80	80	90	90	420
43 Treatment of loans forgiven for solvent farmers .....	20	20	20	20	20	30	30	120
44 Capital gains treatment of certain income .....	880	940	950	950	1,010	980	700	4,590
45 Income averaging for farmers .....	60	60	60	60	60	70	70	320
46 Deferral of gain on sale of farm refiners .....	10	20	20	20	20	20	20	100
47 Bio-Diesel and small agri-biodiesel producer tax credits .....	90	180	200	30	20	10	10	270
<b>Commerce and housing:</b>								
<b>Financial institutions and insurance:</b>								
48 Exemption of credit union income .....	1,320	1,400	1,480	1,570	1,660	1,750	1,850	8,310
49 Excess bad debt reserves of financial institutions .....	20	10	10	10	10	.....	.....	30
50 Exclusion of interest on life insurance savings .....	19,380	20,150	21,925	25,060	27,830	30,090	32,100	137,005
51 Special alternative tax on small property and casualty insurance companies .....	50	50	50	50	50	60	60	270
52 Tax exemption of certain insurance companies owned by tax-exempt organizations .....	220	230	240	250	260	270	280	1,300
53 Small life insurance company deduction .....	60	60	60	60	60	50	50	280
54 Exclusion of interest spread of financial institutions .....	1,350	1,330	1,400	1,480	1,550	1,950	2,050	8,430
<b>Housing:</b>								
55 Exclusion of interest on owner-occupied mortgage subsidy bonds .....	1,170	1,300	1,390	1,430	1,470	1,510	1,560	7,360
56 Exclusion of interest on rental housing bonds .....	970	1,090	1,150	1,180	1,220	1,260	1,300	6,110



**Table 19–1. ESTIMATES OF TOTAL INCOME TAX EXPENDITURES—Continued**  
(in millions of dollars)

	Total from corporations and individuals								
	2006	2007	2008	2009	2010	2011	2012	2008–12	
117	Deductibility of charitable contributions, other than education and health .....	37,120	40,400	45,760	49,360	52,840	56,610	60,740	265,310
118	Exclusion of certain foster care payments .....	440	450	460	470	480	490	500	2,400
119	Exclusion of parsonage allowances .....	480	510	550	580	610	640	670	3,050
120	Employee retention credit for employers affected by Hurricane Katrina, Rita, and Wilma .....		40						
<b>Health:</b>									
121	Exclusion of employer contributions for medical insurance premiums and medical care .....	125,000	141,270	160,190	179,580	200,510	221,880	243,820	1,005,980
122	Self-employed medical insurance premiums .....	3,970	4,370	3,730	4,180	4,670	5,230	5,810	23,620
123	Medical Savings Accounts/Health Savings Accounts .....	280	990	1,980	2,600	2,830	2,910	2,850	13,170
124	Deductibility of medical expenses .....	3,770	4,240	4,920	5,820	6,840	9,250	10,780	37,610
125	Exclusion of interest on hospital construction bonds .....	3,420	3,770	4,010	4,130	4,260	4,380	4,510	21,290
126	Deductibility of charitable contributions (health) .....	4,190	4,560	5,160	5,570	5,960	6,380	6,850	29,920
127	Tax credit for orphan drug research .....	230	260	290	320	360	410	460	1,840
128	Special Blue Cross/Blue Shield deduction .....	620	680	740	610	660	690	740	3,440
129	Tax credit for health insurance purchased by certain displaced and retired individuals <sup>3</sup> .....		10	10	10	10	10	10	50
130	Distributions from retirement plans for premiums for health and long-term care insurance .....		250	240	280	310	340	380	1,550
<b>Income security:</b>									
131	Exclusion of railroad retirement system benefits .....	390	380	380	380	370	360	350	1,840
132	Exclusion of workers' compensation benefits .....	5,660	5,740	5,830	5,920	6,010	6,110	6,200	30,070
133	Exclusion of public assistance benefits (normal tax method) .....	450	470	490	510	530	550	580	2,660
134	Exclusion of special benefits for disabled coal miners .....	50	50	40	40	40	40	40	200
135	Exclusion of military disability pensions .....	110	110	120	130	130	140	150	670
Net exclusion of pension contributions and earnings:									
136	Employer plans .....	49,040	49,510	48,480	48,030	46,350	43,700	42,790	229,350
137	401(k) plans .....	40,760	42,410	43,970	45,980	48,550	54,230	57,690	250,420
138	Individual Retirement Accounts .....	3,970	5,700	6,650	7,130	7,200	7,460	7,840	36,280
139	Low and moderate income savers credit .....	700	690	670	630	610	590	580	3,080
140	Keogh plans .....	10,130	10,860	11,890	13,010	14,230	15,550	16,970	71,650
Exclusion of other employee benefits:									
141	Premiums on group term life insurance .....	2,280	2,310	2,350	2,380	2,420	2,450	2,490	12,090
142	Premiums on accident and disability insurance .....	290	300	310	320	330	340	350	1,650
143	Income of trusts to finance supplementary unemployment benefits .....	20	30	30	30	40	40	50	190
144	Special ESOP rules .....	1,760	1,890	2,030	2,170	2,330	2,490	2,670	11,690
145	Additional deduction for the blind .....	40	40	40	40	40	50	60	230
146	Additional deduction for the elderly .....	1,920	1,830	1,830	1,910	2,010	2,890	3,480	12,120
147	Tax credit for the elderly and disabled .....	20	10	10	10	10	10	10	50
148	Deductibility of casualty losses .....	260	280	300	310	320	350	370	1,650
149	Earned income tax credit <sup>4</sup> .....	5,050	5,360	5,340	5,490	5,660	5,890	7,900	30,280
150	Additional exemption for housing Hurricane Katrina displaced individuals .....	110	20						
<b>Social Security:</b>									
Exclusion of social security benefits:									
151	Social Security benefits for retired workers .....	17,890	18,100	18,930	19,110	20,230	21,320	23,260	102,850
152	Social Security benefits for disabled .....	4,730	5,120	5,620	5,890	6,240	6,690	7,220	31,660
153	Social Security benefits for dependents and survivors .....	3,360	3,340	3,400	3,330	3,420	3,490	3,700	17,340
<b>Veterans benefits and services:</b>									
154	Exclusion of veterans death benefits and disability compensation .....	3,580	3,770	3,890	4,030	4,200	4,590	5,030	21,740
155	Exclusion of veterans pensions .....	150	180	180	180	190	200	230	980
156	Exclusion of GI bill benefits .....	210	260	280	300	320	360	420	1,680
157	Exclusion of interest on veterans housing bonds .....	40	40	40	50	50	50	50	240
<b>General purpose fiscal assistance:</b>									
158	Exclusion of interest on public purpose State and local bonds .....	22,980	25,430	27,150	27,960	28,800	29,670	30,560	144,140
159	Deductibility of nonbusiness state and local taxes other than on owner-occupied homes .....	43,120	33,680	27,900	27,790	28,570	48,560	59,850	192,670
160	Tax credit for corporations receiving income from doing business in U.S. possessions .....	200	20						
<b>Interest:</b>									
161	Deferral of interest on U.S. savings bonds .....	1,260	1,330	1,340	1,360	1,370	1,420	1,520	7,010
<b>Addendum: Aid to State and local governments:</b>									
Deductibility of:									
	Property taxes on owner-occupied homes .....	21,260	15,540	12,620	12,590	12,580	22,440	27,770	88,000
	Nonbusiness State and local taxes other than on owner-occupied homes .....	43,120	33,680	27,900	27,790	28,570	48,560	59,850	192,670
Exclusion of interest on State and local bonds for:									
	Public purposes .....	22,980	25,430	27,150	27,960	28,800	29,670	30,560	144,140
	Energy facilities .....	40	40	50	50	50	50	50	250
	Water, sewage, and hazardous waste disposal facilities .....	510	580	600	630	640	670	680	3,220
	Small-issues .....	510	580	600	630	640	670	680	3,220
	Owner-occupied mortgage subsidies .....	1,170	1,300	1,390	1,430	1,470	1,510	1,560	7,360

**Table 19–1. ESTIMATES OF TOTAL INCOME TAX EXPENDITURES—Continued**  
(in millions of dollars)

	Total from corporations and individuals							
	2006	2007	2008	2009	2010	2011	2012	2008–12
Rental housing .....	970	1,090	1,150	1,180	1,220	1,260	1,300	6,110
Airports, docks, and similar facilities .....	1,130	1,250	1,320	1,360	1,400	1,440	1,480	7,000
Student loans .....	500	550	590	600	630	640	670	3,130
Private nonprofit educational facilities .....	2,140	2,380	2,530	2,610	2,690	2,770	2,850	13,450
Hospital construction .....	3,420	3,770	4,010	4,130	4,260	4,380	4,510	21,290
Veterans' housing .....	40	40	40	50	50	50	50	240
Credit for holders of zone academy bonds .....	130	140	160	170	170	170	160	830

<sup>1</sup>In addition, the alcohol fuel credit results in a reduction in excise tax receipts (in millions of dollars) as follows: 2006 \$2,570; 2007 \$2,990; 2008 \$3,460; 2009 \$4,280; 2010 \$4,990; 2011 \$1,440; 0 in 2012.

<sup>2</sup>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: 2006 \$15,473; 2007 \$14,931; 2008 \$14,367; 2009 \$14,019; 2010 \$13,651; 2011 \$13,410; and 2012 \$1,275.

<sup>3</sup>The figures in the table indicate the effect of the health insurance tax credit on receipts. The effect of the credit on outlays (in millions of dollars) is as follows: 2006 \$90; 2007 \$100; 2008 \$110; 2009 \$120; 2010 \$130; 2011 \$140; and 2012 \$150.

<sup>4</sup>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: 2006 \$36,166; 2007 \$36,461; 2008 \$37,573; 2009 \$38,237; 2010 \$38,994; 2011 \$40,289; and 2012 \$36,982.

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 com-

plement 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 2006 which cause the deferrals or other long-term revenue effects. For instance, a pension contribution in 2006 would cause a deferral of tax payments on wages in 2006 and on pension earnings on this contribution (e.g., interest) in later years. In some future year, however, the 2006 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							
	2006	2007	2008	2009	2010	2011	2012	2008-12	2006	2007	2008	2009	2010	2011	2012	2008-12
<b>National Defense</b>																
1 Exclusion of benefits and allowances to armed forces personnel .....									3,100	3,220	3,350	3,480	3,620	3,780	3,930	18,160
<b>International affairs:</b>																
2 Exclusion of income earned abroad by U.S. citizens .....									2,500	2,630	2,760	2,900	3,050	3,200	3,360	15,270
3 Exclusion of certain allowances for Federal employees abroad .....									800	840	880	920	970	1,020	1,070	4,860
4 Extraterritorial income exclusion .....	4,400	1,630														
5 Inventory property sales source rules exception .....	1,730	1,890	2,120	2,330	2,510	2,704	2,913	12,577								
6 Deferral of income from controlled foreign corporations (normal tax method) .....	11,160	11,940	12,770	13,650	14,600	15,620	16,710	73,350								
7 Deferred taxes for financial firms on certain income earned overseas .....	2,260	2,370	2,490	1,060				3,550								
<b>General science, space, and technology:</b>																
8 Expensing of research and experimentation expenditures (normal tax method) .....	7,770	5,570	5,170	3,980	4,920	6,100	5,880	26,050	150	110	110	80	110	130	120	550
9 Credit for increasing research activities .....	2,120	10,260	4,910	2,100	920	360	70	8,360	60	60	50					50
<b>Energy:</b>																
10 Expensing of exploration and development costs, fuels .....	590	750	730	620	520	390	270	2,530	90	110	110	90	80	60	40	380
11 Excess of percentage over cost depletion, fuels .....	680	710	710	710	700	680	670	3,470	80	80	80	80	80	80	70	390
12 Alternative fuel production credit .....	2,860	2,270	750	10	10			770	120	100	30					30
13 Exception from passive loss limitation for working interests in oil and gas properties .....									30	30	30	30	30	30	30	150
14 Capital gains treatment of royalties on coal .....									160	170	170	170	190	180	130	840
15 Exclusion of interest on energy facility bonds .....	10	10	10	10	10	10	10	50	30	30	40	40	40	40	40	200
16 New technology credit .....	470	640	900	1,060	1,090	1,090	1,090	5,230	40	50	60	60	60	60	60	300
17 Alcohol fuel credits <sup>1</sup> .....	40	40	50	50	60	20		180	10	10	10	20	20	10		60
18 Tax credit and deduction for clean-fuel burning vehicles .....	40	30		-30	-30	-40	-50	-150	70	230	150	160	10	-10	-10	300
19 Exclusion of utility conservation subsidies .....									110	110	110	110	110	110	100	540
20 Credit for holding clean renewable energy bonds .....	10	30	40	50	50	50	50	240	10	30	40	50	50	50	50	240
21 Deferral of gain from dispositions of transmission property to implement FERC restructuring policy .....	620	530	230	-100	-360	-510	-540	-1,280								
22 Credit for investment in clean coal facilities .....		30	50	80	130	180	250	690								
23 Temporary 50% expensing for equipment used in the refining of liquid fuels .....	10	30	120	240	260	180	-50	750								
24 Natural gas distribution pipelines treated as 15-year property .....	20	50	90	120	150	150	120	630								
25 Amortize all geological and geophysical expenditures over 2 years .....	10	50	70	60	30	10	10	180		10	20	10	10			40
26 Allowance of deduction for certain energy efficient commercial building property ..	60	140	130	70	20	-10	-10	200	20	50	40	20	10			70
27 Credit for construction of new energy efficient homes .....	10	20	20	20	10			50			10					10
28 Credit for energy efficiency improvements to existing homes .....									230	380	150					150
29 Credit for energy efficient appliances .....	120	80														
30 30% credit for residential purchases/installations of solar and fuel cells .....									10	10	10					10
31 Credit for business installation of qualified fuel cells and stationary microturbine power plants .....	60	70	100	40	-10	-10	-10	110	20	20	30	10				40
32 Partial expensing for advanced mine safety equipment .....		10	20						20							
<b>Natural resources and environment:</b>																
33 Expensing of exploration and development costs, nonfuel minerals .....	10	10	10	10	10	10	10	50								
34 Excess of percentage over cost depletion, nonfuel minerals .....	430	460	470	480	500	520	540	2,510	20	20	20	30	30	30	30	140
35 Exclusion of interest on bonds for water, sewage, and hazardous waste facilities ..	120	140	140	150	150	160	160	760	390	440	460	480	490	510	520	2,460
36 Capital gains treatment of certain timber income .....									160	170	170	170	190	180	130	840
37 Expensing of multiperiod timber growing costs .....	200	220	230	240	250	260	270	1,250	90	90	90	90	100	100	100	480
38 Tax incentives for preservation of historic structures .....	300	310	330	340	360	380	400	1,810	90	90	100	100	110	110	120	540
39 Expensing of capital costs with respect to complying with EPA sulfur regulations ..	10	10	30	50	30			110								
40 Exclusion of gain or loss on sale or exchange of certain brownfield sites .....		10	20	30	30	30	20	130			10	10	10	10	10	50
<b>Agriculture:</b>																
41 Expensing of certain capital outlays .....	20	20	20	20	20	30	30	120	110	110	110	120	120	120	120	590









**Table 19-2. ESTIMATES OF TAX EXPENDITURES FOR THE CORPORATE AND INDIVIDUAL INCOME TAXES—Continued**  
(in millions of dollars)

	Corporations								Individuals							
	2006	2007	2008	2009	2010	2011	2012	2008-12	2006	2007	2008	2009	2010	2011	2012	2008-12
Credit for holders of zone academy bonds ..	130	140	160	170	170	170	160	830	.....	.....	.....	.....	.....	.....	.....	.....

<sup>1</sup>In addition, the alcohol fuel credit results in a reduction in excise tax receipts (in millions of dollars) as follows: 2006 \$2,570; 2007 \$2,990; 2008 \$3,460; 2009 \$4,280; 2010 \$4,990; 2011 \$1,440; 0 in 2012.

<sup>2</sup>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: 2006 \$15,473; 2007 \$14,931; 2008 \$14,367; 2009 \$14,019; 2010 \$13,651; 2011 \$13,410; and 2012 \$1,275.

<sup>3</sup>The figures in the table indicate the effect of the health insurance tax credit on receipts. The effect of the credit on outlays (in millions of dollars) is as follows: 2006 \$90; 2007 \$100; 2008 \$110; 2009 \$120; 2010 \$130; 2011 \$140; and 2012 \$150.

<sup>4</sup>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: 2006 \$36,166; 2007 \$36,461; 2008 \$37,573; 2009 \$38,237; 2010 \$38,994; 2011 \$40,289; and 2012 \$36,982.

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, neither 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) are regarded as tax expenditures. 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.

- A separate corporate income tax is not part of a comprehensive income tax.
- Tax rates vary by level of income. Multiple tax rates exist as a means to facilitate the redistribution 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 nor does gross income include most transfer payments which can be thought of as gifts from the

Government.<sup>3</sup> The normal tax baseline also excludes gifts between individuals from gross income. Under the normal tax baseline, however, all cash transfer payments from the Government 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.<sup>4</sup>

*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. Appendix A 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 2008-2012 PROJECTED REVENUE EFFECT**

(in millions of dollars)

	Provision	2008	2008-12
121	Exclusion of employer contributions for medical insurance premiums and medical care .....	160,190	1,005,980
57	Deductibility of mortgage interest on owner-occupied homes .....	89,430	520,260
73	Accelerated depreciation of machinery and equipment (normal tax method) .....	64,670	421,790
117	Deductibility of charitable contributions, other than education and health .....	45,760	265,310
67	Capital gains (except agriculture, timber, iron ore, and coal) .....	51,960	251,880
137	401(k) plans .....	43,970	250,420
136	Employer plans .....	48,480	229,350
61	Exclusion of net imputed rental income .....	35,680	220,176
60	Capital gains exclusion on home sales .....	38,890	214,870
159	Deductibility of nonbusiness State and local taxes other than on owner-occupied homes .....	27,900	192,670
69	Step-up basis of capital gains at death .....	35,900	191,060
158	Exclusion of interest on public purpose State and local bonds .....	27,150	144,140
50	Exclusion of interest on life insurance savings .....	21,925	137,005
114	Child tax credit .....	32,341	134,666
151	Social Security benefits for retired workers .....	18,930	102,850
77	Deduction for U.S. production activities .....	13,810	97,110
58	Deductibility of State and local property tax on owner-occupied homes .....	12,620	88,000
6	Deferral of income from controlled foreign corporations (normal tax method) .....	12,770	73,350
64	Accelerated depreciation on rental housing (normal tax method) .....	12,300	73,320
140	Keogh plans .....	11,890	71,650
62	Exception from passive loss rules for \$25,000 of rental loss .....	7,520	39,750
124	Deductibility of medical expenses .....	4,920	37,610
138	Individual Retirement Accounts .....	6,650	36,280
152	Social Security benefits for disabled .....	5,620	31,660
149	Earned income tax credit .....	5,340	30,280
132	Exclusion of workers' compensation benefits .....	5,830	30,070
126	Deductibility of charitable contributions (health) .....	5,160	29,920
103	Deductibility of charitable contributions (education) .....	5,120	29,630
63	Credit for low-income housing investments .....	4,940	27,800
8	Expensing of research and experimentation expenditures (normal tax method) .....	5,280	26,600
122	Self-employed medical insurance premiums .....	3,730	23,620
75	Graduated corporation income tax rate (normal tax method) .....	4,240	22,200
154	Exclusion of veterans death benefits and disability compensation .....	3,890	21,740
125	Exclusion of interest on hospital construction bonds .....	4,010	21,290
92	HOPE tax credit .....	3,350	19,740

<sup>3</sup> Gross income does, however, include transfer payments associated with past employment, such as Social Security benefits.

<sup>4</sup> 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 2008-2012 PROJECTED REVENUE EFFECT—Continued**  
(in millions of dollars)

	Provision	2008	2008-12
1	Exclusion of benefits and allowances to armed forces personnel .....	3,350	18,160
153	Social Security benefits for dependents and survivors .....	3,400	17,340
80	Exclusion of reimbursed employee parking expenses .....	3,040	16,550
2	Exclusion of income earned abroad by U.S. citizens .....	2,760	15,270
99	Exclusion of interest on bonds for private nonprofit educational facilities .....	2,530	13,450
123	Medical Savings Accounts / Health Savings Accounts .....	1,980	13,170
93	Lifetime Learning tax credit .....	2,200	12,700
5	Inventory property sales source rules exception .....	2,120	12,577
146	Additional deduction for the elderly .....	1,830	12,120
141	Premiums on group term life insurance .....	2,350	12,090
144	Special ESOP rules .....	2,030	11,690
91	Exclusion of scholarship and fellowship income (normal tax method) .....	1,960	10,770
70	Carryover basis of capital gains on gifts .....	760	10,670
102	Parental personal exemption for students age 19 or over .....	1,590	10,140
74	Expensing of certain small investments (normal tax method) .....	5,330	9,910
54	Exclusion of interest spread of financial institutions .....	1,400	8,430
9	Credit for increasing research activities .....	4,960	8,410
48	Exemption of credit union income .....	1,480	8,310
115	Credit for child and dependent care expenses .....	1,740	7,890
97	State prepaid tuition plans .....	1,000	7,500
55	Exclusion of interest on owner-occupied mortgage subsidy bonds .....	1,390	7,360
161	Deferral of interest on U.S. savings bonds .....	1,340	7,010
59	Deferral of income from installment sales .....	1,230	7,000
85	Exclusion of interest for airport, dock, and similar bonds .....	1,320	7,000
56	Exclusion of interest on rental housing bonds .....	1,150	6,110
109	Employer provided child care exclusion .....	1,030	5,620
16	New technology credit .....	960	5,530
87	Empowerment zones, Enterprise communities, and Renewal communities .....	1,480	5,340
113	Exclusion of employee meals and lodging (other than military) .....	970	5,320
3	Exclusion of certain allowances for Federal employees abroad .....	880	4,860
72	Accelerated depreciation of buildings other than rental housing (normal tax method) .....	-310	4,650
44	Capital gains treatment of certain income .....	950	4,590
81	Exclusion for employer-provided transit passes .....	710	4,370
88	New markets tax credit .....	990	4,140
11	Excess of percentage over cost depletion, fuels .....	790	3,860
95	Deductibility of student-loan interest .....	820	3,800
7	Deferred taxes for financial firms on certain income earned overseas .....	2,490	3,550
128	Special Blue Cross/Blue Shield deduction .....	740	3,440
35	Exclusion of interest on bonds for water, sewage, and hazardous waste facilities .....	600	3,220
76	Exclusion of interest on small issue bonds .....	600	3,220
98	Exclusion of interest on student-loan bonds .....	590	3,130
139	Low and moderate income savers credit .....	670	3,080
119	Exclusion of parsonage allowances .....	550	3,050
10	Expensing of exploration and development costs, fuels .....	840	2,910
133	Exclusion of public assistance benefits (normal tax method) .....	490	2,660
34	Excess of percentage over cost depletion, nonfuel minerals .....	490	2,650
112	Adoption credit and exclusion .....	570	2,460
111	Assistance for adopted foster children .....	400	2,420
118	Exclusion of certain foster care payments .....	460	2,400
38	Tax incentives for preservation of historic structures .....	430	2,350
104	Exclusion of employer-provided educational assistance .....	660	2,110
68	Capital gains exclusion of small corporation stock .....	320	2,060
127	Tax credit for orphan drug research .....	290	1,840
131	Exclusion of railroad retirement system benefits .....	380	1,840
37	Expensing of multiperiod timber growing costs .....	320	1,730
156	Exclusion of GI bill benefits .....	280	1,680
142	Premiums on accident and disability insurance .....	310	1,650
148	Deductibility of casualty losses .....	300	1,650
130	Distributions from retirement plans for premiums for health and long-term care insurance .....	240	1,550
52	Tax exemption of certain insurance companies owned by tax-exempt organizations .....	240	1,300
96	Deduction for higher education expenses .....	1,180	1,180
155	Exclusion of veterans pensions .....	180	980
107	Work opportunity tax credit .....	370	870
14	Capital gains treatment of royalties on coal .....	170	840
36	Capital gains treatment of certain timber income .....	170	840
100	Credit for holders of zone academy bonds .....	160	830
12	Alternative fuel production credit .....	780	800
23	Temporary 50% expensing for equipment used in the refining of liquid fuels .....	120	750

**Table 19–3. INCOME TAX EXPENDITURES RANKED BY TOTAL 2008–2012 PROJECTED REVENUE EFFECT—Continued**  
(in millions of dollars)

	Provision	2008	2008–12
41	Expensing of certain capital outlays .....	130	710
22	Credit for investment in clean coal facilities .....	50	690
135	Exclusion of military disability pensions .....	120	670
24	Natural gas distribution pipelines treated as 15-year property .....	90	630
19	Exclusion of utility conservation subsidies .....	110	540
20	Credit for holding clean renewable energy bonds .....	80	480
83	Exclusion of interest on bonds for Financing of Highway Projects and rail-truck transfer facilities .....	75	465
42	Expensing of certain multiperiod production costs .....	80	420
86	Exemption of certain mutuals' and cooperatives' income .....	80	420
45	Income averaging for farmers .....	60	320
53	Small life insurance company deduction .....	60	280
71	Ordinary income treatment of loss from small business corporation stock sale .....	50	280
26	Allowance of deduction for certain energy efficient commercial building property .....	170	270
47	Bio-Diesel tax credit .....	200	270
51	Special alternative tax on small property and casualty insurance companies .....	50	270
15	Exclusion of interest on energy facility bonds .....	50	250
66	Exceptions from imputed interest rules .....	50	250
17	Alcohol fuel credits .....	60	240
65	Cancellation of indebtedness .....	90	240
82	Tax credit for certain expenditures for maintaining railroad tracks .....	130	240
157	Exclusion of interest on veterans housing bonds .....	40	240
145	Additional deduction for the blind .....	40	230
25	Amortize all geological and geophysical expenditures over 2 years .....	90	220
84	Investment credit for rehabilitation of structures (other than historic) .....	40	200
134	Exclusion of special benefits for disabled coal miners .....	40	200
143	Income of trusts to finance supplementary unemployment benefits .....	30	190
40	Exclusion of gain or loss on sale or exchange of certain brownfield sites .....	30	180
108	Welfare-to-work tax credit .....	80	170
105	Special deduction for teacher expenses .....	160	160
13	Exception from passive loss limitation for working interests in oil and gas properties .....	30	150
18	Tax credit and deduction for clean-fuel burning vehicles .....	150	150
28	Credit for energy efficiency improvements to existing homes .....	150	150
31	Credit for business installation of qualified fuel cells and stationary microturbine power plants .....	130	150
116	Credit for disabled access expenditures .....	30	150
43	Treatment of loans forgiven for solvent farmers .....	20	120
39	Expensing of capital costs with respect to complying with EPA sulfur regulations .....	30	110
46	Deferral of gain on sale of farm refiners .....	20	100
79	Deferral of tax on shipping companies .....	20	100
94	Education Individual Retirement Accounts .....	10	100
101	Exclusion of interest on savings bonds redeemed to finance educational expenses .....	20	100
106	Discharge of student loan indebtedness .....	20	100
27	Credit for construction of new energy efficient homes .....	30	60
110	Employer-provided child care credit .....	10	60
33	Expensing of exploration and development costs, nonfuel minerals .....	10	50
90	Credit to holders of Gulf Tax Credit Bonds .....	10	50
129	Tax credit for health insurance purchased by certain displaced and retired individuals .....	10	50
147	Tax credit for the elderly and disabled .....	10	50
49	Excess bad debt reserves of financial institutions .....	10	30
32	Partial expensing for advanced mine safety equipment .....	20	20
89	Expensing of environmental remediation costs .....	130	20
30	30% credit for residential purchases/installations of solar and fuel cells .....	10	10
4	Extraterritorial income exclusion .....		
29	Credit for energy efficient appliances .....		
120	Employee retention credit for employers affected by Hurricane Katrina, Rita, and Wilma .....		
150	Additional exemption for housing Hurricane Katrina displaced individuals .....		
160	Tax credit for corporations receiving income from doing business in U.S. possessions .....		
78	Special rules for certain film and TV production .....	70	-170
21	Deferral of gain from dispositions of transmission property to implement FERC restructuring policy .....	230	-1,280

**Table 19-4. PRESENT VALUE OF SELECTED TAX EXPENDITURES FOR ACTIVITY IN CALENDAR YEAR 2006**

(in millions of dollars)

	Provision	2006 Present Value of Revenue Loss
1	Deferral of income from controlled foreign corporations (normal tax method) .....	10,520
2	Deferred taxes for financial firms on income earned overseas .....	2,380
3	Expensing of research and experimentation expenditures (normal tax method) .....	2,690
4	Expensing of exploration and development costs—fuels .....	260
5	Expensing of exploration and development costs—nonfuels .....	10
6	Expensing of multiperiod timber growing costs .....	160
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 .....	19,750
10	Accelerated depreciation on rental housing .....	16,240
11	Accelerated depreciation of buildings other than rental .....	10,510
12	Accelerated depreciation of machinery and equipment .....	68,430
13	Expensing of certain small investments (normal tax method) .....	860
14	Deferral of tax on shipping companies .....	20
15	Credit for holders of zone academy bonds .....	210
16	Credit for low-income housing investments .....	4,530
17	Deferral for state prepaid tuition plans .....	4,730
18	Exclusion of pension contributions—employer plans .....	75,660
19	Exclusion of 401(k) contributions .....	110,000
20	Exclusion of IRA contributions and earnings .....	4,100
21	Exclusion of contributions and earnings for Keogh plans .....	7,640
22	Exclusion of interest on public-purpose bonds .....	20,420
23	Exclusion of interest on non-public purpose bonds .....	6,900
24	Deferral of interest on U.S. savings bonds .....	420
25	Exclusion of Roth earnings and distributions .....	8,380
26	Exclusion of non-deductible IRA earnings .....	400

### Double Taxation of Corporate Profits

In a gradual transition to a more economically neutral tax system under which all income is taxed no more than once, the lower tax rates on dividends and capital gains on corporate equity under current law 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. Appendix A provides a greater discussion of alternative baselines.

### 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, 2006, and do not reflect proposals made elsewhere in the Budget. Legislation enacted in 2006, such as the Tax Increase Prevention and Reconciliation Act of 2005 (TIPRA), the Pension Protection Act of 2006 (PPA), and the Tax Relief and Health Care Act of 2006

(TRHCA) extended and expanded the scope of many existing provisions.

TIPRA extended the 15 percent tax rate for dividends and capital gains through December 31, 2010, and the higher limit for certain investment that can be expensed through December 31, 2009.

Provisions extended or expanded by the PPA include:

- the low-income saver's credit (made permanent)
- Section 529 education savings provisions (made permanent)
- the maximum contribution and benefit limits under qualified pension plans (made permanent)
- the enhanced charitable deduction for food and book inventories
- the indexation of the IRA contribution limits (and higher limits made permanent)
- allowing for tax-free distributions from retirement plans for premiums for health and long-term care insurance for public safety officers
- tax-free distributions from IRAs to public charities

Provisions extended or expanded by the TRHCA include:

- the deduction for tuition and teaching related expenses
- the new markets tax credit
- the deduction for State and local sales taxes
- the research and experimentation tax credit
- the work opportunity and welfare to work tax credits
- qualified zone academy bonds

- expensing of remediation costs
- charitable contributions of computers and scientific property
- credit for clean renewable energy bonds
- credits for construction of new energy efficient homes and commercial buildings
- credits for alternative technologies
- select empowerment zone incentives

Chapter 17 on Federal Receipts has more detailed descriptions of the provisions of these three bills.

### 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, then 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 (\$77,793 in 2006).

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**<sup>5</sup>.—The exclusion for extraterritorial income was repealed by the American Jobs Creation Act of 2004. Under the transition rules, taxpayers retain 80 percent of ETI benefits for 2005, 60 percent 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 earn-

ings 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 incremental credit regime. Under the alternative incremental 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). Beginning in 2007, the rates for the alternative incremental credit increases to a range of 3 percent to 5 percent. An alternative simplified credit is also allowed which is equal to 12 percent of qualified research expenses that exceed 50 percent of the average qualified research expenses for the three preceding taxable years. A 20-percent credit with a separate threshold is provided 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, 2008 and extends to research conducted in Puerto Rico and the U.S. possessions.

<sup>5</sup>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.



## 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. A credit is also 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.

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 taxexempt. These bonds are

generally subject to the State private-activity bond annual volume cap.

16. **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 2008) and 10 percent of the basis of geothermal property placed in service during the taxable year. A credit is also available for certain electricity produced from wind energy, biomass, geothermal energy, solar energy, small irrigation power, municipal solid waste, or qualified hydropower and sold to an unrelated party. The credit rate in 2006 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. Another credit is available for refined coal. The credit rate in 2006 is \$5.679 per ton and the rate is indexed in subsequent years. An additional credit is available for the production of Indian coal. The value of the credit is \$1.50 per ton in 2006 and indexed for inflation in subsequent years.

17. **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.

18. **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. 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.

19. **Exclusion of utility conservation subsidies.**—Non-business customers can exclude from gross income

subsidies received from public utilities for expenditures on energy conservation measures.

20. **Credit to holders of clean renewable energy bonds.**—This provision provides for up to \$800 million in aggregate issuance of Clean Renewable Energy Bonds (CREBs) through December 31, 2008. Taxpayers holding CREBs on a credit allowance date are entitled to a tax credit in lieu of interest.

21. **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.

22. **Credit for investment in clean coal facilities.**—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.

23. **Temporary 50 percent expensing for equipment used in the refining of liquid fuels.**—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.

24. **Natural gas distribution pipelines treated as 15-year property.**—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.

25. **Amortize all geological and geophysical expenditures over 2 years.**—Geological and geophysical amounts incurred in connection with oil and gas exploration in the United States may be amortized over two years for non-integrated oil companies and five years for certain major integrated oil companies. 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.

26. **Allowance of deduction for certain energy efficient commercial building property.**—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.

27. **Credit for construction of new energy efficient homes.**—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, 2009.

28. **Credit for energy efficiency improvements to existing homes.**—A 10 percent investment tax credit up to \$500 is available for expenditures on insulation, exterior windows and doors that improve the energy efficiency of homes and meet certain standards. 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.

29. **Credit for energy efficient appliances.**—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.

30. **Credit for residential purchases/installations of solar and fuel cells.**—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, 2009.

31. **Credit for business installation of qualified fuel cells and stationary microturbine power plants.**—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.

32. **Partial expensing for advanced mine safety equipment.**—Qualified mine safety equipment may be expensed rather than depreciated over time. Provision limited to property placed in service on or before December 31, 2008.

### Natural Resources and Environment

33. **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.

34. **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.

35. **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.

36. **Capital gains treatment of certain timber.**—Certain timber sales can be treated as a capital gain rather than ordinary income.

37. **Expensing multi-period 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.

38. **Historic preservation.**—Expenditures to preserve and restore historic structures qualify for a 20-percent investment tax credit, but the depreciable basis must be reduced by the full amount of the credit taken.

39. **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.

40. **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

41. **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.

42. **Expensing multi-period 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.

43. **Loans forgiven solvent farmers.**—Farmers are forgiven the tax liability on certain forgiven debt. Normally, debtors must include the amount of loan forgive-

ness 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.

44. **Capital gains treatment of certain income.**—Certain agricultural income, such as unharvested crops, can be treated as capital gains rather than ordinary income.

45. **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.

46. **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.

47. **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 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 from 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.

48. **Credit union income.**—The earnings of credit unions not distributed to members as interest or dividends are exempt from income tax.

49. **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.

50. **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.

**51. *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.

**52. *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.

**53. *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.

**54. *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.

**55. *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.

**56. *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.

**57. *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.

**58. *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.

**59. *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.

**60. *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.

**61. 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. Appendix A provides a fuller explanation of this new addition to the tax expenditure budget.

**62. 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.

**63. 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.

**64. 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 Appendix A.

**65. 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.

**66. 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.

**67. 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.

The Jobs Growth Tax Relief Reconciliation Act (JGTRRA) lowered the top tax rate on capital gains from 20 percent to 15 percent, which is effective through 2010. For taxpayers in the 15 percent or below ordinary tax bracket, JGTRRA lowered the tax rate on capital gains to 5 percent (0 percent in 2008). These lower rates apply to assets held for more than one year.

Previously, 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.

**68. 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.

**69. 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.

**70. 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.

**71. 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.

**72. 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 Appendix A.

**73. 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 Appendix A.

**74. 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 extent 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 2009, 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 2009.

**75. 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 rate is considered a tax expenditure under this concept.

**76. 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.

**77. 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.

**78. 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

**79. 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.

**80. 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 2006, the maximum amount of the parking exclusion is \$250 (indexed) per month. The tax expenditure estimate does not include parking at facilities owned by the employer.

**81. Exclusion of employee transit pass expenses.**—Transit passes, tokens, fare cards, and van-pool 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 2006, the maximum amount of the exclusion is \$105 (indexed) per month.

**82. 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.

**83. 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. The authority to issue these bonds expires on December 31, 2015.

### Community and Regional Development

84. **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.

85. **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.

86. **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.

87. **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 2007.

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.

88. **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 the primary mission of which 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 2008. Credit authority is allo-

cated to CDEs through a competitive application process.

89. **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, 2007 to be eligible for expensing.

90. **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

91. **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).

92. **HOPE tax credit.**—The non-refundable HOPE tax credit allows a credit for 100 percent of an eligible student's first \$1,100 of tuition and fees and 50 percent of the next \$1,100 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 2006, the credit is phased out ratably for taxpayers with modified AGI between \$90,000 and \$110,000 (\$45,000 and \$55,000 for singles), indexed.

93. **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 \$90,000 and \$110,000 (\$45,000 and \$55,000 for singles) (indexed beginning in 2002). The credit applies to both undergraduate and graduate students.

94. **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 2006 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).

95. **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 2006, 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.

96. **Deduction for Higher Education Expenses.**—The maximum annual deduction for qualified higher education expenses is \$4,000 in 2007 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, 2007.

97. **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.

98. **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.

99. **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.

100. **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 2007.

101. **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 \$94,700 and \$124,700 (\$63,100 and \$78,100 for singles) in 2006.

102. **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.

103. **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.

104. **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.

105. **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). Provision expires at end of December 31, 2007.

106. **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.

107. **Work opportunity tax credit.**—Employers can claim a tax credit for qualified wages paid to individuals who begin work on or before December 31, 2007 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. Employees must work at least 120 hours to be eligible for the credit. 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. The Tax Relief and Health Care Act of 2006 modified the Work opportunity tax credit



by changing definitions of the Food Stamp and Ex-Convict target groups and adding persons eligible for the Welfare-to-work credit as a new WOTC target group with a \$10,000 ceiling on qualified first year wages and a 50 percent credit on qualified second year wages up to \$10,000. Under the 2006 Act, qualified employees hired through December 31, 2007, are eligible for the modified WOTC credit..

108. **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. Employees must work at least 400 hours to be eligible for the credit. The maximum credit is \$8,500 per employee. The credit applies to wages paid to employees who are hired on or before December 31, 2006. The Tax Relief and Health Care Act of 2006 modified the Welfare to Work credit by making qualified long-term family assistance recipients a WOTC target group after December 31, 2007.

109. **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.

110. **Employer-provided child care credit.**—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.

111. **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.

112. **Adoption credit and exclusion.**—Taxpayers can receive a nonrefundable tax credit for qualified adoption expenses. The maximum credit is \$10,960 per child for 2006, and is phased-out ratably for taxpayers with modified AGI between \$164,410 and \$204,410. 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.

113. **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.

114. **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).

115. **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. In 2006, 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.

116. **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.

117. **Charitable contributions, other than education and health.**—Taxpayers may deduct contributions to charitable, religious, and certain other non-profit 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.

118. **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.

119. **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.

120. **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 prin-

cial 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

121. **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.

122. **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 deductible percentage is 60 percent in 2001, 70 percent in 2002, and 100 percent in 2003 and thereafter.

123. **Medical and health savings accounts.**—Individual contributions to Archer Medical Savings Accounts (Archer MSAs) and Health Savings Accounts (HSAs) are allowed as a deduction in determining adjusted gross income whether or not the individual itemizes deductions. Employer contributions to Archer MSAs and HSAs are excluded from income and employment taxes. Archer MSAs and HSAs require that the individual have coverage by a qualifying high deductible health plan. Earnings from the accounts are excluded from taxable income. Distributions from the accounts used for medical expenses are not taxable. The rules for HSAs are generally more flexible than for Archer MSAs and the deductible contribution amounts are greater (in 2007, \$2850 for taxpayers with individual coverage and \$5,650 for taxpayers with family coverage). Thus, HSAs have largely replaced MSAs.

124. **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.

125. **Hospital construction bonds.**—Interest earned on State and local government debt issued to finance hospital construction is excluded from income subject to tax.

126. **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.

127. **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.

128. **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 applica-

ble insurance company income tax accounting rules that substantially reduce (or even eliminate) their tax liabilities.

129. **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.

130. **Distributions for premiums for health and long-term care insurance.**—This provision provides for tax-free distributions of up to \$3,000 from governmental retirement plans for premiums for health and long term care premiums of public safety officers.

### Income Security

131. **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.

132. **Workers' compensation benefits.**—Workers compensation provides payments to disabled workers. These benefits, although income to the recipients, are not subject to the income tax.

133. **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.

134. **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.

135. **Military disability pensions.**—Most of the military pension income received by current disabled retired veterans is excluded from their income subject to tax.

136. **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.

137. **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 2006, an employee could exclude up to \$15,000 (indexed) of wages from AGI under a qualified arrangement with an employer's 401(k) plan. 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.

138. **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 2006, and \$5,000 in 2008 (indexed thereafter) and allows taxpayers over age 50 to make additional "catch-up" contributions of \$1,000.

Taxpayers whose AGI is below \$85,000 (\$65,000 for non-joint filers) in 2006 can claim a deduction for IRA contributions. The IRA deduction is phased out for taxpayers with AGI between \$75,000 and \$85,000 (\$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 59½, (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.

139. **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.

140. **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 \$44,000 in 2006. 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.

141. **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.

142. **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.

143. **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.

144. **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.

145. **Additional deduction for the blind.**—Taxpayers who are blind may take an additional \$1,250 standard deduction if single, or \$1,000 if married in 2006.

146. **Additional deduction for the elderly.**—Taxpayers who are 65 years or older may take an additional \$1,250 standard deduction if single, or \$1,000 if married in 2006.

147. **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.

148. **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.

149. **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 \$8,080 of earned income in 2006. The credit is 40 percent of the first \$11,340 of income for a family with two or more qualifying children. The credit is phased out beginning when the taxpayer's income exceeds \$14,810 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 \$32,001 (\$36,348 if two or more qualifying children are present), \$34,001 (or \$38,348) 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 2006, the credit is 7.65 percent of the first \$5,380 of earned income. When the taxpayer's income exceeds \$6,740 (8,740 if married), the credit is phased out at the rate of 7.65 percent. It is completely phased out at \$12,120 (\$14,120 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 2006 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.

150. **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

151. **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.

152. **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.

153. **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

154. **Veterans death benefits and disability compensation.**—All compensation due to death or disability paid by the Veterans Administration is excluded from taxable income.

155. **Veterans pension payments.**—Pension payments made by the Veterans Administration are excluded from gross income.

156. **G.I. Bill benefits.**—G.I. Bill benefits paid by the Veterans Administration are excluded from gross income.

157. **Tax-exempt mortgage bonds for veteran.**—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

158. **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.

159. **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.

160. **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

161. **U.S. savings bonds.**—Taxpayers may defer paying tax on interest earned on U.S. savings bonds until the bonds are redeemed.

## Appendix A

### 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 chapter, tax expenditures are measured relative to normal law or reference law baselines that deviate from a comprehensive concept of income. Consequently, tax expenditures identified in the Budget can differ from those that would be identified under a comprehensive income tax baseline. This appendix compares major tax expenditures listed in the tax expenditure budget with those implied by a comprehensive income baseline.

Current budgetary practice excludes from the list of tax expenditures those provisions that over-tax certain items of income because the original motivation for the analysis was to identify tax provisions that substitute 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.

##### *Major Tax Expenditures from the Traditional 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 and only once. Thus, it would not levy a separate tax on corporate

income leading to the double taxation of corporate profits.

Comprehensive income is widely held to be the idealized base for an income tax even though it is not a perfectly defined concept.<sup>6</sup> 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 such as housing, automobiles, and major appliances.

Furthermore, comprehensive income does not necessarily represent an ideal tax base; economic efficiency would be improved by deviating from comprehensive income as a tax base by reducing the tax on capital income to spur economic growth further or by subsidizing certain types of activities to correct for market failures. 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.

Table 1 classifies fifteen 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 reflect the hybrid nature of the existing tax system and arise out of policy decisions to reduce the high tax rate on capital income that would otherwise arise. Even these relatively clear-cut items, how-

<sup>6</sup>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.

ever, can raise ambiguities in light of the absence of integration of the corporate and individual tax systems. For example, 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 because the income is taxed first at the corporate level. A similar line of reasoning suggests that in the case of corporations, expensing<sup>7</sup> of R&E or accelerated depreciation are not tax expenditures because they 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 continue to 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 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 benefits when paid (since it represents an increase in net worth).<sup>8</sup> 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 any proceeds 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 displays items that probably are tax expenditures, but that raise additional issues. Current law, for instance, allows deductions for home mortgage interest and for property taxes on owner-occupied housing. The tax expenditure budget includes both of these provisions. A comprehensive tax base would allow both deductions, but it would also include imputed gross rental income. Current law does not include gross rental income, however, and so on this basis the home mortgage interest deduction and the deduction for property taxes on owner-occupied housing are properly tax expenditures under a comprehensive income tax base.<sup>9</sup> 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.

The deduction of nonbusiness State and local taxes other than on owner-occupied homes also is included in Panel B. The 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.<sup>10</sup> 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.<sup>11</sup>

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.<sup>12</sup> 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.<sup>13</sup>

The comprehensive income tax base is an objective measure of income. Traditionally, this measure is modified to reflect a subjective or social economic policy concern regarding the financial ability of an individual to pay tax. Absent this modification, provisions such as the personal exemption and the child tax credit would be treated as tax expenditures. However, once the definition of income is modified to reflect the ability of an individual to pay tax, then these and similar provisions are typically dropped from the list of tax expenditures.

The step-up of basis at death lowers the tax on capital gains for those who inherit assets. From that perspective it would be a tax expenditure under a comprehensive income baseline. Nonetheless, there are ambiguities. Under a comprehensive income baseline, all inflation-adjusted gains would be taxed as accrued, so there would be no deferred unrealized gains on assets held at death.

The partial exclusion of Social Security benefits from tax is also listed in panel B. To the extent Social Security is viewed as a pension, comprehensive income would include all contributions to Social Security retirement funds (payroll taxes) and tax accretions to value as they arise.<sup>14</sup> Benefits paid out of contributions and the inside build-up in value, however, would not be

<sup>7</sup>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.

<sup>8</sup>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.

<sup>9</sup>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).

<sup>10</sup>Fiscal Year 2003 Budget of the United States Government, Analytical Perspectives (Washington, D.C.: U.S. Government Printing Office, 2002) p. 127.

<sup>11</sup>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.

<sup>12</sup>U.S. Treasury, Blueprints for Basic Tax Reform (Washington, D.C.: U.S. Government Printing Office, 1977) p. 92.

<sup>13</sup>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.

<sup>14</sup>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.

included 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 income and all benefits received should be included.

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<sup>15</sup> reflect exemptions for lower-income beneficiaries from the tax on 85 percent of Social Security benefits.<sup>16</sup> 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<sup>17</sup>. Hence, the tax expenditure budget understates the tax advantage accorded Social Security retirement benefits relative to a comprehensive income baseline.

The deduction for U.S. production activities also raises 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 then represent a feature of the baseline tax rate system because the deduction is equivalent to a lower tax rate. In addition, it might not be a tax expenditure to the extent it is viewed as providing relief from the double tax on corporate profits.

<sup>15</sup>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.

<sup>16</sup>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.

<sup>17</sup>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.

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 may serve as proxies for provisions that would be a tax expenditure under a comprehensive income base.<sup>18</sup>

For example, under existing law charitable contributions are deductible, and this deduction is considered on its face a tax expenditure in the current budget.<sup>19</sup> The treatment of charitable donations, however, is ambiguous under a comprehensive income tax. If charitable contributions are a consumption item for the giver, then they are properly included in his taxable income and a deduction for contributions would be a tax expenditure under a comprehensive income tax base. 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 the charitable deduction 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 is not taxed.<sup>20</sup>

Medical expenditures may or may not be an element of income. These expenditures may be viewed as a reduction of net worth (e.g. cost of earning income) rather than as discretionary spending, and so are not really consumption and should be excluded from the tax base. However, expenditures for medical care may be considered as indistinguishable from other consumption items which are not excluded from a comprehensive income base.

The exemption of full taxation of Social Security benefits paid to the disabled also raises issues. Social Security benefits for the disabled most closely resemble either Government transfers or insurance. From either perspective, a comprehensive income tax would require that the benefit be included in income and would allow a deduction for 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 tax expenditure budget displays the benefit of exempting 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

<sup>18</sup>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.

<sup>19</sup>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.

<sup>20</sup>If recipients tend to be in lower tax brackets, then the tax expenditure is smaller than when measured at the donor's tax rates.

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 half of the premium might suggest that 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.<sup>21</sup>

#### *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,<sup>22</sup> and benefits received from private charities. Under some theories 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, might measure the income of U.S. residents properly.

#### *Negative Tax Expenditures*

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.

Human capital is generally considered a productive asset, and so its cost (e.g., certain education and training expenses, including perhaps the cost of college and professional school) should be amortizable under a comprehensive income tax, but it is not under current law.<sup>23</sup>

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.<sup>24</sup> 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 and so 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.<sup>25</sup>

## **DIFFERENCES BETWEEN OFFICIAL TAX EXPENDITURES AND TAX EXPENDITURES RELATIVE TO A CONSUMPTION TAX BASE**

This section compares tax expenditures listed in the tax expenditure budget with those implied by a comprehensive consumption tax baseline. It first discusses some of the difficulties encountered in contemplating current tax provisions as part of a comprehensive consumption tax. Next, it assesses which of the thirty largest income tax expenditures would be tax expenditures

under the consumption tax baseline, concluding that about half would remain under a consumption tax baseline. Most that fall off the list are incentives for saving and investment.

The section next discusses some major differences between current law and a comprehensive consumption tax baseline. These differences include the consumption

<sup>21</sup> 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.

<sup>22</sup> To the extent that premiums are deductible.

<sup>23</sup> 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.

<sup>24</sup> See Bradford, *Untangling the Income Tax*, p. 41.

<sup>25</sup> 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.



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 can be viewed as 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. Some issues arise which are also 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 discussed earlier in the context of the comprehensive income tax is determining whether a particular expenditure, such as spending on medical care and charitable donations, is an item of consumption.

Also, 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 include 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 an investment's income (or yield) is equivalent to consumption tax treatment with respect to the normal rate of return on new investment; expensing generates a tax reduction

that offsets in present value terms the tax paid on the investment's future normal returns. Because of this equivalence, in the context of consumption taxes, a yield exemption approach is sometimes called a tax prepayment approach. That is, tax is paid on an asset's purchase price rather than on the consumption flow that it generates.

However, a yield exemption approach differs from a pure consumption tax with respect to the distribution of income and Government revenue. Pure profits in excess of the normal rate of return would be taxed under a consumption tax because pure profits are an element of cash flow; however, pure profits would not be taxed under a yield exemption tax system. The question arises whether an exemption of certain kinds of investment income, and certain investment tax credits, should 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.

Considering provisions individually can be misleading. The hybrid character of the existing tax system reflects many provisions that might be good policy 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, if financial flows are excluded from the tax base, then the deduction for home mortgage interest would be a tax expenditure except that current law generally taxes interest income. When combined with the mortgage interest deduction, this offsets the inclusion of 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, the effects of these transactions would cancel out in the economy as a whole. The classification below generally views available capital gains tax relief as consistent with a broad-based consumption tax because they lower tax rate on capital income is consistent with a consumption-based tax.

Such considerations suggest that, as with an income tax, computing the current tax's deviations from "the" base of a consumption tax is difficult because deviations cannot always be uniquely determined, making it problematic to do a 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 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 six (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.

In one respect 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 a deduction for principal repayments.

From another perspective, however, the home mortgage interest deduction would not be a tax expenditure under a consumption tax. Under a consumption tax, the interest income accruing to the mortgage lender generally would not be taxed (at least in present value terms). As interest income is subject to tax under current law, 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.<sup>26</sup>

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, al-

<sup>26</sup>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.

though 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 based on 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 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 would be a tax expenditure relative to a consumption base.

As discussed in the section on comprehensive income, whether the deduction for State and local income taxes gives rise to a tax expenditure under a consumption tax depends on whether the services paid for with these taxes constitute consumption value to the taxpayer. If there is not a firm relationship between the taxes paid and the services received, then the deduction may not be viewed as a tax expenditure.

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, yielding a stream of services that current federal tax law fails to impute to income.

The tax expenditures for Social Security benefits discussed in the section on comprehensive income measure 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 would correspond to including 50 percent of Social Security benefits in the recipient's tax base.<sup>27</sup> Thus, the existing tax expenditure is correct conceptually, but is not measured properly relative to a comprehensive income tax. A similar analysis would

<sup>27</sup>The current tax expenditure estimates reflect 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.

apply to the exclusion of Social Security benefits of dependents and retirees.

There is a strong case for viewing the child tax credit and the earned income tax credit as social welfare programs (transfers). As such, they would be tax expenditures relative to a consumption baseline. These credits could alternatively be viewed as relieving tax on “non-discretionary” 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.

There also is the issue of how to tax medical insurance premiums. Under current law, employees may exclude insurance premiums paid for by employers from 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 included in the tax base because they represent consumption. Yet an alternative perspective would support excluding the premium from the tax base as long as the value of any medical services paid for by the insurance policy were included. 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.

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, 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 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. 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 possible tax expenditures 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 theories 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 provisions are called negative tax expenditures.

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 requires 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 net operating loss 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). Human capital is a productive asset, and so 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 Alternative Minimum Tax 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, 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.<sup>28</sup> 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.<sup>29</sup> 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 inter-

est, depreciation, property taxes, and other costs associated with earning the rental income. Thus, a comprehensive 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.<sup>30</sup>

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 income tax advantage to housing; they overlook the additional exclusion of implicit net rental income. To the extent 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. On the other hand, a homeowner with a mortgage approximately matching the value of the house might make interest payments that exceed the implicit rental income. 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.<sup>31</sup>

<sup>28</sup>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.

<sup>29</sup>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.

<sup>30</sup>The homeowner's tax base under a comprehensive income tax is net rents. Under current law, the homeowner's tax base is  $-(\text{interest} + \text{property taxes})$ . 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.

<sup>31</sup>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.

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.<sup>32</sup>

#### *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 than 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 A 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.

<sup>32</sup>National Income and Production Accounts, Table 2.4.

**Appendix Table 1. COMPARISON OF CURRENT TAX EXPENDITURES WITH THOSE IMPLIED BY A COMPREHENSIVE INCOME TAX <sup>1</sup>**

Description	Revenue Effect 2008
<i>A. Tax Expenditure Under a Comprehensive Income Tax</i>	
Accelerated depreciation of machinery and equipment (normal tax method) .....	64,670
Capital gains (except agriculture, timber, iron ore, and coal) .....	51,960
Net exclusion of pension contributions and earnings: Employer plans .....	48,480
Net exclusion of pension contributions and earnings: 401(k) plans .....	43,970
Capital gains exclusion on home sales .....	38,890
Exclusion of net imputed rental income on owner-occupied housing .....	35,680
Exclusion of interest on public purpose State and local bonds .....	27,150
Exclusion of interest on life insurance savings .....	21,925
Deferral of income from controlled foreign corporations (normal tax method) .....	12,770
Accelerated depreciation on rental housing (normal tax method) .....	12,300
Net exclusion of pension contributions and earnings: Keogh plans .....	11,890
Net exclusion of pension contributions and earnings: Individual Retirement Accounts .....	6,650
Exclusion of workers' compensation benefits .....	5,830
Expensing of research and experimentation expenditures (normal tax method) .....	5,280
Credit for low-income housing investments .....	4,940
<i>B. Possibly a Tax Expenditure Under a Comprehensive Income Tax, But With Some Qualifications</i>	
Deductibility of mortgage interest on owner-occupied homes .....	89,430
Step-up basis of capital gains at death .....	35,900
Child tax credit .....	32,341
Deductibility of nonbusiness State and local taxes other than on owner-occupied homes .....	27,900
Exclusion of Social Security benefits for retired workers .....	18,930
Deduction for U.S. production activities .....	13,810
Deductibility of State and local property tax on owner-occupied homes .....	12,620
Earned income tax credit .....	5,340
<i>C. Uncertain</i>	
Exclusion of employer contributions for medical insurance premiums and medical care .....	160,190
Deductibility of charitable contributions, other than education and health .....	45,760
Social Security benefits for the disabled .....	5,620
Deductibility of charitable contributions, health .....	5,160
Deductibility of charitable contributions, education .....	5,120
Deductibility of medical expenses .....	4,920
<i>D. Probably Not a Tax Expenditure Under a Comprehensive Income Tax</i>	
Exception from passive loss rules for \$25,000 of rental loss .....	7,520

<sup>1</sup> 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 <sup>1</sup>**

Description	Revenue Effect 2008
<i>A. Tax Expenditure Under a Consumption Base</i>	
Exclusion of workers' compensation benefits .....	5,830
<i>B. Probably a Tax Expenditure Under a Consumption Base</i>	
Deductibility of mortgage interest on owner-occupied homes .....	89,430
Child tax credit .....	32,341
Deductibility of nonbusiness State and local taxes other than on owner-occupied homes .....	27,900
Exclusion of Social Security benefits for retired workers .....	18,930
Deductibility of State and local property tax on owner-occupied homes .....	12,620
Earned income tax credit .....	5,340
<i>C. Uncertain</i>	
Exclusion of employer contributions for medical insurance premiums and medical care .....	160,190
Deductibility of charitable contributions, other than education and health .....	45,760
Exclusion of net imputed rental income on owner-occupied housing .....	35,680
Social Security benefits for disabled .....	5,620
Credit for low-income housing investments .....	4,940
Deductibility of medical expenses .....	4,920
Deductibility of charitable contributions, health .....	5,160
Deductibility of charitable contributions, education .....	5,120
<i>D. Not a Tax Expenditure Under a Consumption Base</i>	
Accelerated depreciation of machinery and equipment (normal tax method) .....	64,670
Capital gains (except agriculture, timber, iron ore, and coal) .....	51,960
Net exclusion of pension contributions and earnings: Employer plans .....	48,480
Net exclusion of pension contributions and earnings: 401(k) plans .....	43,970
Capital gains exclusion on home sales .....	38,890
Step-up basis of capital gains at death .....	35,900
Exclusion of interest on public purpose State and local bonds .....	27,150
Exclusion of interest on life insurance savings .....	21,925
Deduction for U.S. production activities .....	13,810
Deferral of income from controlled foreign corporations (normal tax method) .....	12,770
Accelerated depreciation on rental housing (normal tax method) .....	12,300
Net exclusion of pension contributions and earnings: Keogh plans .....	11,890
Exception from passive loss rules for \$25,000 of rental loss .....	7,520
Net exclusion of pension contributions and earnings: Individual Retirement Accounts .....	6,650
Expensing of research and experimentation expenditures (normal tax method) .....	5,280

<sup>1</sup> 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 <sup>1</sup>**

Provision	Revenue Loss						
	2006	2007	2008	2009	2010	2011	2012
Imputed Rent On Owner-Occupied Housing .....	28,780	32,110	35,680	39,440	43,596	48,190	53,269
Double Tax on corporate profit <sup>2</sup> .....	-33,530	-34,930	-36,160	-37,280	-38,435	-39,625	-40,852

<sup>1</sup> Calculations described in the appendix text.

<sup>2</sup> This is a negative tax expenditure, a tax provision that overtaxes income relative to the treatment specified by the baseline tax system.

## Appendix B

### 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. This Appendix responds to the report of the Senate Governmental Affairs Committee on GPRA<sup>33</sup> calling 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.

*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.<sup>34</sup> 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 activi-

ties 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.

<sup>33</sup> Committee on Government Affairs, United States Senate, "Government Performance and Results Act of 1993" (Report 103-58, 1993).

<sup>34</sup> 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.



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 intended 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 pro-

duction 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.



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# DIMENSIONS OF THE BUDGET

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## 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 ac-

tual results for 2006 with the current services estimates shown in the 2006 Budget, published in February 2005.

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 lengthens the focus to estimates made for each year of the budget horizon, extending four years beyond the budget year. This longer 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 2006

This part of the chapter compares the actual receipts, outlays, and deficit for 2006 with the current services estimates shown in the 2006 Budget, published in February 2005.<sup>1</sup> 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 2006 previously published by the Department of the Treasury.

#### Receipts

Actual receipts for 2006 were \$2,407 billion, \$229 billion more than the \$2,178 billion current services estimate in the 2006 Budget (February 2005). 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.

**Table 20–1. COMPARISON OF ACTUAL 2006 RECEIPTS WITH THE INITIAL CURRENT SERVICES ESTIMATES**

(In billions of dollars)

	February 2005 estimate	Enacted legislation/administrative actions	Different economic conditions	Technical factors	Net change	Actual
Individual income taxes .....	965	-11	10	81	79	1,044
Corporation income taxes .....	223	*	-5	136	131	354
Social insurance and retirement receipts .....	819	.....	16	3	19	838
Excise taxes .....	76	*	-1	-1	-2	74
Estate and gift taxes .....	26	1	*	1	2	28
Customs duties .....	27	-*	1	-3	-2	25
Miscellaneous receipts .....	43	*	3	-1	2	45
<b>Total receipts .....</b>	<b>2,178</b>	<b>-10</b>	<b>23</b>	<b>216</b>	<b>229</b>	<b>2,407</b>

\* \$500 million or less.

*Policy differences.* Several laws were enacted after February 2005 that reduced 2006 receipts by a net \$10 billion. The emergency tax relief provided to individuals and businesses affected by hurricanes Katrina, Rita and Wilma in the Katrina Emergency Tax Relief

Act of 2005 and the Gulf Opportunity Zone Act of 2005 accounted for \$5 billion of the net reduction in 2006 receipts. The provisions of the Tax Increase Prevention and Reconciliation Act of 2005 (TIPRA), primarily the increase in the alternative minimum tax (AMT) exemp-

<sup>1</sup>The current services concept is discussed in Chapter 24, “Current Services Estimates.” For mandatory programs and receipts, the February 2005 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 was based on the current year estimates, excluding one-time emergency appropriations, adjusted for inflation.

tion amount and a modification of the timing of estimated tax payments by corporations, also reduced 2006 receipts by a net \$5 billion. The effects of other legislative and administrative changes on 2006 receipts were largely offsetting.

*Economic differences.* Differences between the economic assumptions upon which the current services estimates were based and actual economic performance increased 2006 receipts by a net \$23 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 \$10 billion and \$16 billion, respectively. These increases were partially offset by a \$5 billion decrease in corporation income taxes, attributable to lower-than-expected corporate profits. Differences between anticipated and actual economic performance increased other sources of receipts by a net \$3 billion.

*Technical reestimates.* Technical factors increased 2006 receipts by a net \$216 billion above the February 2005 current services estimate. This net increase was primarily attributable to higher-than-anticipated collections of individual and corporation income taxes of \$81 billion and \$136 billion, respectively. Different collection patterns and effective tax rates than assumed in February 2005 were primarily responsible for the higher-than-anticipated collections of individual and corporation income taxes. Changes in other sources of receipts attributable to technical factors were largely offsetting.

### Outlays

Outlays for 2006 were \$2,655 billion, \$116 billion more than the \$2,539 billion current services estimate in the 2006 Budget (February 2005).

Table 20–2 distributes the \$116 billion net increase in outlays among discretionary and mandatory pro-

grams and net interest.<sup>2</sup> 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 2006, policy changes increased outlays by an estimated \$160 billion relative to the initial current services estimates.

Policy changes increased discretionary outlays by \$141 billion. Defense discretionary outlays increased by \$93 billion and nondefense discretionary outlays increased by \$48 billion. A significant portion of both defense and nondefense outlay increases resulted from enactment of emergency supplemental appropriation acts for defense, the Global War on Terror, and hurricane recovery in 2005 and 2006. Policy changes increased mandatory outlays by a net \$15 billion above current law. This increase largely reflects a \$19 billion increase in outlays for the National flood insurance program in response to hurricane recovery, partly offset by a \$5 billion decrease in Medicare outlays, largely enacted in the Deficit Reduction Act of 2005.

Economic conditions that differed from those forecast in February 2005 resulted in a net increase in outlays of \$18 billion. The most significant changes consist of a \$7 billion increase in Social Security benefits largely resulting from higher cost-of-living adjustments and a \$12 billion increase in net interest due to higher-than-expected interest rates.

Technical estimating differences and other changes resulted in a net decrease in outlays of \$61 billion. Technical changes result from changes in such factors

<sup>2</sup> 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 2006 OUTLAYS WITH THE INITIAL CURRENT SERVICES ESTIMATES**

(Outlays in billions)

	Current Services (Feb. 2005)	Changes				Actual
		Policy	Economic	Technical	Total changes	
Discretionary:						
Defense .....	437	93	.....	–11	83	520
Nondefense .....	477	48	.....	–28	20	497
Subtotal, discretionary .....	914	141	.....	–39	103	1,017
Mandatory:						
Social Security .....	540	.....	7	–3	4	544
Other programs .....	876	15	–1	–22	–7	868
Subtotal, mandatory .....	1,416	15	6	–25	–4	1,412
Net interest .....	209	3	12	2	17	227
Total outlays .....	2,539	160	18	–61	116	2,655



**Table 20-3. COMPARISON OF THE ACTUAL 2006 DEFICIT WITH THE INITIAL CURRENT SERVICES ESTIMATE**

(In billions)

	Current Services (Feb. 2005)	Changes				Actual
		Policy	Economic	Technical	Total changes	
Receipts .....	2,178	-10	23	216	229	2,407
Outlays .....	2,539	160	18	-61	116	2,655
Deficit .....	361	170	-6	-277	-113	248

Note: Deficit changes are outlays minus receipts. For these changes, a plus indicates an increase in the deficit.

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 decreased an estimated \$39 billion, because budget authority for both defense and nondefense programs was spent more slowly than expected. Outlays for mandatory programs decreased by a net \$25 billion, largely because higher-than-anticipated outlays for higher education and mortgage credit programs were more than offset by lower-than-anticipated outlays for Medicaid, Medicare, unemployment compensation, and other programs. Net interest outlays increased by \$2 billion due to technical factors compared to the February 2005 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 2006. This section combines these effects to show the net impact of these differences.

As shown in Table 20-3, the 2006 current services deficit was initially estimated to be \$361 billion. The actual deficit was \$248 billion, which was a \$113 billion decrease from the initial estimate. Receipts were \$229 billion more than the initial estimate and outlays were \$116 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 \$170 billion. Economic conditions that differed from the initial assumptions in February 2005 accounted for an estimated \$6 billion decrease in the deficit. Technical factors reduced the deficit by an estimated \$277 billion.

### Comparison of the Actual and Estimated Outlays for Mandatory and Related Programs for 2006

This section compares the original 2006 outlay estimates for mandatory and related programs under current law in the 2006 Budget (February 2005) with the actual outlays. Major examples of these programs include Social Security and Medicare benefits, 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 2006 and the amounts originally estimated in the 2006 Budget, based on laws in effect at that time. Actual outlays for mandatory spending and net interest in 2006 were \$1,639 billion, which was \$14 billion more than the initial estimate of \$1,625 billion, based on existing law in February 2005.

As Table 20-4 shows, actual outlays for mandatory human resources programs were \$1,444 billion, \$6 billion less than originally estimated. This decrease 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 \$4 billion more than originally estimated. Undistributed offsetting receipts were \$1 billion higher than expected, thus reducing total outlays.

Outlays for net interest were \$227 billion, or \$17 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 deficits, and technical factors.

### Reconciliation of Differences with Amounts Published by Treasury for 2006

Table 20-5 provides a reconciliation of the receipts, outlays, and deficit totals published by the Department of the Treasury in the September 2006 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 by \$6 million and increased outlays by \$499 million. Nearly all of the outlay adjustment was the correction of reporting for the Exchange Stabilization Fund. Additional adjustments for this Budget increased receipts and outlays by \$579 million and \$557 million, respectively. Several financial transactions that are not reported to the De-

**Table 20-4. COMPARISON OF ACTUAL AND ESTIMATED OUTLAYS FOR MANDATORY AND RELATED PROGRAMS UNDER CURRENT LAW**

(In billions of dollars)

	2006		
	Feb. 2006 estimate	Actual	Change
Mandatory outlays:			
Human resources programs:			
Education, training, employment, and social services .....	11	38	27
Health:			
Medicaid .....	193	181	-12
Other .....	20	21	1
Total health .....	213	201	-11
Medicare .....	340	325	-15
Income security:			
Retirement and disability .....	106	102	-3
Unemployment compensation .....	37	31	-6
Food and nutrition assistance .....	51	48	-3
Other .....	113	116	3
Total, income security .....	307	298	-9
Social security .....	540	544	4
Veterans benefits and services:			
Income security for veterans .....	35	36	*
Other .....	3	2	-1
Total veterans benefits and services .....	38	37	-1
Total mandatory human resources programs .....	1,449	1,444	-6
Other functions:			
Agriculture .....	21	20	-1
International .....	-2	-7	-4
Deposit insurance .....	-1	-1	—*
Other functions .....	15	24	9
Total, other functions .....	33	37	4
Undistributed offsetting receipts:			
Employer share, employee retirement .....	-60	-61	-1
Rents and royalties on the outer continental shelf .....	-7	-7	—*
Other undistributed offsetting receipts .....	—*	—*	—*
Total undistributed offsetting receipts .....	-67	-68	-1
Total, mandatory .....	1,416	1,412	-4
Net interest:			
Interest on Treasury debt securities (gross) .....	391	406	15
Interest received by trust funds .....	-172	-169	2
Other interest .....	-10	-10	—*
Total net interest .....	209	227	17
Total outlays for mandatory and net interest .....	1,625	1,639	14

\* \$500 million or less.

partment 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. Reporting for these programs adds roughly equivalent amounts to outlays and receipts, with little impact on the deficit. Another significant conceptual difference in reporting is for the National Railroad Retirement

Investment Trust (NRRIT). 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 2005 through August 2006. The budget has been adjusted to reflect transactions that occurred during the actual fiscal year, which begins in October.

**Table 20-5. RECONCILIATION OF FINAL AMOUNTS FOR 2006**

(In millions of dollars)

	Receipts	Outlays	Deficit
Totals published by Treasury (September 30 MTS) .....	2,406,681	2,654,379	-247,698
Miscellaneous Treasury adjustments .....	-6	499	-505
Totals published by Treasury in Combined Statement .....	2,406,675	2,654,878	-248,203
Affordable Housing Program .....	307	307	.....
Public Company Accounting Oversight Board .....	131	131	.....
United Mine Workers of America benefit funds .....	119	114	5
National Railroad Retirement Investment Trust .....	.....	-48	48
Other .....	22	53	-31
Total adjustments, net .....	579	557	22
Totals in the budget .....	2,407,254	2,655,435	-248,181
MEMORANDUM:			
Total change since year-end statement .....	573	1,056	-483

**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 and a half 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 2006 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 \$20 billion over the 25-year period. Policy outcomes that differed from the original proposals increased the deficit by an average of \$34 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 \$26 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 on 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. Since 1982, the average absolute difference has been \$99 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 \$136 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

**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 <sup>1</sup>	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
2006 .....	–390	–141	6	277	142	–248
Average .....	.....	–34	–12	26	–20	.....
Absolute average <sup>2</sup> .....	.....	38	39	70	99	.....
Standard deviation .....	.....	46	57	94	136	.....

<sup>1</sup> Surplus or deficit estimate includes the effect of the budget's policy proposals.

<sup>2</sup> Absolute average is the average without regard to sign.

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 difference 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 \$26 billion,

but underestimated the deficit in the budget year by \$20 billion. The budget estimates understated the deficit in the years following, by amounts growing from \$59 billion for BY+1 to \$141 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 \$58 billion in the current year to \$99 billion for the budget year, to \$269 billion for BY+4. While under- and overestimates of the deficit have historically tended to average out, the 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 \$71 billion for current year estimates to \$136 billion for the budget year estimates and continues to increase steadily as the estimates extend further out, reaching \$289 billion for BY+4.

**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 <sup>1</sup> .....	26	-20	-59	-97	-128	-141
Average absolute difference <sup>2</sup> .....	58	99	149	202	245	269
Standard deviation .....	71	136	202	249	271	289

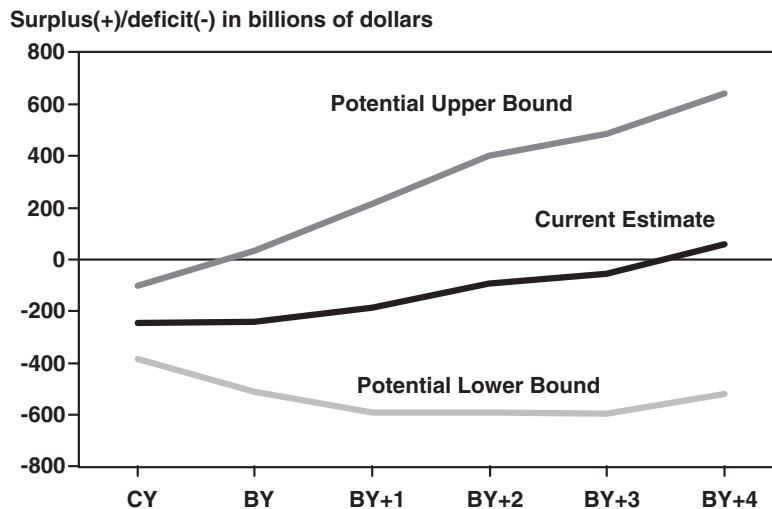
<sup>1</sup> A positive figure represents an underestimate of the surplus or an overestimate of the deficit.

<sup>2</sup> Average absolute difference is the difference without regard to sign.

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

The usual measure of total outlays in the budget is a net measure. First, gross outlays are net of payments from other Federal Government accounts. For example, if account A paid account B \$100 to do some work and account B used \$100 to pay for salaries, materials, and supplies to do the work, gross outlays would be \$200 while the impact on the nation's economy would be only \$100. Netting is done to take out the double count. For all presentations in this chapter, this type of netting is assumed. Second, and more important, is that gross outlays are net of offsetting collections and offsetting receipts from the public. In this case, a net basis of reporting is more significant, since it measures the extent to which general taxpayers are contributing to operating deficits. A counter argument is that net treatment conceals important information. Table 21-1 provides a gross presentation of outlays to the public to permit users of budget information the flexibility to use gross or net outlays. The table shows outlays gross and net of offsetting collections and offsetting receipts from the public for all major agencies.

In 2008, net outlays of \$2,902 billion consist of gross outlays of \$3,221 billion less offsetting collections and receipts from the public of \$319 billion. The table shows that offsetting receipts and offsetting collections from the public are relatively more important for some agen-

cies than for others. For example, in 2008 the Postal Service is estimated to have gross outlays of \$75 billion but net outlays of -\$2 billion, due to offsetting collections and receipts of \$77 billion from the sale of stamps and other income. In contrast, gross and net outlays for the National Aeronautics and Space Administration (NASA) are very similar, because NASA has relatively few offsetting receipts and collections from the public.

In Table 21-1, negative 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 also deducted from the Government-wide outlay totals but not from any specific agency. These consist principally of rents and royalties on oil and gas production on the Outer Continental Shelf and proceeds from the auction of rights to the electromagnetic spectrum.

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. 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, 2006-2008**

(In millions of dollars)

Department or Other Unit	2006			2007			2008		
	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 .....	4,203	-75	4,128	4,378	-72	4,306	4,776	-72	4,704
Judicial Branch .....	5,875	-52	5,823	5,911	-66	5,845	6,730	-69	6,661
Executive Branch									
Department of Agriculture .....	112,884	-19,350	93,534	109,523	-20,756	88,767	108,964	-19,938	89,026
Department of Commerce .....	8,908	-2,535	6,373	8,121	-1,942	6,179	9,133	-2,055	7,078
Department of Defense—Military .....	513,353	-13,996	499,357	561,800	-12,885	548,915	595,837	-12,554	583,283
Department of Education .....	94,758	-1,329	93,429	74,403	-6,363	68,040	63,568	-4,965	58,603
Department of Energy .....	26,244	-6,595	19,649	28,380	-6,392	21,988	28,343	-6,476	21,867
Department of Health and Human Services .....	669,477	-55,162	614,315	737,727	-66,473	671,254	770,580	-71,340	699,240
Department of Homeland Security .....	78,589	-9,491	69,098	60,601	-10,183	50,418	54,690	-11,490	43,200
Department of Housing and Urban Development .....	45,397	-2,962	42,435	46,839	-4,005	42,834	46,509	-2,107	44,402
Department of the Interior .....	16,357	-7,293	9,064	16,838	-5,961	10,877	16,983	-6,455	10,528
Department of Justice .....	24,567	-1,243	23,324	24,006	-967	23,039	25,086	-1,041	24,045
Department of Labor .....	46,350	-3,212	43,138	51,230	-3,790	47,440	55,937	-3,641	52,296
Department of State .....	13,910	-948	12,962	17,640	-1,318	16,322	18,385	-1,582	16,803
Department of Transportation .....	60,827	-688	60,139	64,089	-314	63,775	67,373	-341	67,032
Department of the Treasury .....	480,937	-16,225	464,712	508,178	-17,671	490,507	543,672	-18,682	524,990
Department of Veterans Affairs .....	76,196	-6,389	69,807	78,425	-6,100	72,325	88,293	-5,005	83,288
Corps of Engineers-Civil Works .....	9,543	-2,599	6,944	8,632	-1,075	7,557	7,535	-1,055	6,480
Other Defense Civil Programs .....	44,451	-15	44,436	47,650	-14	47,636	49,112	-14	49,098

**Table 21-1. TOTAL OUTLAYS, GROSS AND NET OF OFFSETTING COLLECTIONS AND RECEIPTS—Continued  
FROM THE PUBLIC, BY AGENCY, 2006-2008**

(In millions of dollars)

Department or Other Unit	2006			2007			2008		
	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
Environmental Protection Agency .....	8,728	-407	8,321	8,404	-366	8,038	8,208	-430	7,778
Executive Office of the President .....	5,382	-3	5,379	2,679	-2	2,677	1,391	-2	1,389
General Services Administration .....	721	-697	24	1,002	-504	498	1,350	-522	828
International Assistance Programs .....	29,776	-15,832	13,944	33,382	-16,321	17,061	31,885	-13,926	17,959
National Aeronautics and Space Administration .....	11,878	3,247	15,125	16,381	-238	16,143	17,488	-238	17,250
National Science Foundation .....	5,546	-4	5,542	5,862	-2	5,860	6,028	-2	6,026
Office of Personnel Management .....	73,561	-11,161	62,400	70,364	-11,562	58,802	76,371	-12,209	64,162
Small Business Administration .....	1,976	-1,071	905	1,508	-833	675	781	-56	725
Social Security Administration .....	593,142	-7,399	585,743	630,650	-7,731	622,919	662,085	-7,618	654,467
Export-Import Bank of the United States .....	334	-2,525	-2,191	474	-1,811	-1,337	247	-220	27
Federal Deposit Insurance Corporation .....	-425	-252	-677	-944	-865	-1,809	-367	-2,526	-2,893
Postal Service .....	69,377	-70,348	-971	76,417	-73,672	2,745	74,527	-76,733	-2,206
Railroad Retirement Board .....	6,012	-2,690	3,322	6,404	-2,408	3,996	6,657	-1,474	5,183
Other Independent Agencies .....	26,816	-13,366	13,450	27,748	-12,635	15,113	27,902	-12,927	14,975
Allowances .....				8,002		8,002	2,269		2,269
Undistributed Offsetting Receipts .....	-230,152	-7,396	-237,548	-242,450	-20,690	-263,140	-257,206	-21,496	-278,702
<b>Totals .....</b>	<b>2,935,498</b>	<b>-280,063</b>	<b>2,655,435</b>	<b>3,100,254</b>	<b>-315,987</b>	<b>2,784,267</b>	<b>3,221,122</b>	<b>-319,261</b>	<b>2,901,861</b>



## 22. TRUST FUNDS AND FEDERAL FUNDS

When money is received by the Federal Government, it is credited to an account, and when money is spent by the Government, it is taken from an account. All budget accounts belong to one of two 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 accounts for a larger share of the budget than the trust funds group, and includes all transactions that are not required by law to pass through trust funds.

The Federal funds group includes the general fund, which is the largest fund in the Government and is used to carry out the general purposes of Government rather than being restricted by law to a specific program. The general fund receives all collections not earmarked by law for some other fund, including virtually all income taxes and many excise taxes. Together with Treasury borrowing, the general fund finances all expenditures not financed by earmarked collections.

The Federal funds group also includes special funds and revolving funds, which receive earmarked collections for spending on specific purposes. Where the law requires that Federal fund collections be earmarked to finance a particular program, the collections and associated disbursements are recorded in special fund receipt and expenditure accounts. An example is the portion of the Outer Continental Shelf mineral leasing receipts deposited into the Land and Water Conservation Fund. The majority of special fund collections are derived from the Government's power to impose taxes, fines, and other compulsory payments. Money in these funds must be appropriated before it can be obligated and spent. Although a majority of special fund collections are derived from the Government's power to compel payment, 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 are used to conduct continuing cycles of business-like activity. Revolving funds receive money collected from the sale of products or services and these proceeds are used to finance spending of the program providing the products or services. Instead of being deposited in receipt accounts, the programs' proceeds are recorded in the revolving funds, which are expenditure accounts. The proceeds collected in this way are generally available automatically for obligation and expenditure. Outlays for programs with revolving funds

are reported net of these collections, which are known as "offsetting collections" because they offset outlays rather than being recorded as Governmental receipts. 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 receive earmarked collections for spending on specific purposes. Many of the larger trust funds are used to finance social insurance payments, 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. There are also a few small trust funds that have been established to carry out the terms of a conditional gift or bequest.

There is no substantive difference between special funds in the Federal funds group and trust funds or, as noted below, 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.<sup>1</sup>

The meaning of the term "trust" in the Federal Government budget differs significantly from the private sector usage. The beneficiary of a private trust owns the trust's income and often its assets. A custodian or trustee manages the assets on behalf of the beneficiary according to the stipulations of the trust, which neither the trustee nor the beneficiary can change unilaterally. In contrast, the Federal Government owns the assets and the 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

<sup>1</sup>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.

pursuant to a trust agreement whereby the Government acts as the trustee, and even then the Government generally owns these funds and has some ability to alter the amount deposited into or paid out of these funds. Deposit funds, which are funds held by the Government as a custodian on behalf of some non-governmental entity, are similar to private-sector trust funds. The Government makes no decisions about the amount of money placed in deposit funds or about how the proceeds 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 required by law to be invested in Treasury securities.<sup>2</sup>

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 trust 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 are used to conduct a cycle of business-type operations; offsetting collections are credited to the funds (which are also 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 in the aggregate (netted to avoid double-counting) from which the total unified budget receipts, outlays, and surplus or deficit are derived. 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 into receipt accounts. Outgo consists of

**Table 22-1. RECEIPTS, OUTLAYS AND SURPLUS OR DEFICIT BY FUND GROUP**

(In billions of dollars)

	2006 Actual	Estimate					
		2007	2008	2009	2010	2011	2012
<b>Receipts:</b>							
Federal funds cash income:							
From the public .....	1,569.8	1,679.9	1,742.1	1,834.9	1,926.5	2,020.7	2,171.3
From trust funds: .....	2.1	24.8	4.2	1.5	1.5	1.6	1.8
Total, Federal funds cash income .....	1,572.0	1,704.7	1,746.3	1,836.3	1,928.1	2,022.3	2,173.1
Trust funds cash income:							
From the public .....	961.5	1012.1	1069.7	1114.7	1177.2	1241.1	1302.7
From Federal funds:							
Interest .....	171.3	183.5	194.8	208.1	223.7	239.7	254.8
Other .....	298.9	316.3	338.1	352.2	374.9	403.2	428.6
Total, trust funds cash income .....	1,431.7	1,511.9	1,602.6	1,675.0	1,775.8	1,884.0	1,986.1
Offsetting receipts .....	-596.4	-676.5	-686.4	-713.0	-749.1	-802.8	-851.9
Total, unified budget receipts .....	2,407.3	2,540.1	2,662.5	2,798.3	2,954.7	3,103.6	3,307.3
<b>Outlays:</b>							
Federal funds cash outgo .....	2,109.2	2,194.4	2,279.6	2,334.5	2,357.0	2,425.4	2,469.8
Trust funds cash outgo .....	1,142.6	1,266.3	1,308.7	1,363.9	1,441.2	1,534.7	1,628.4
Offsetting receipts .....	-596.4	-676.5	-686.4	-713.0	-749.1	-802.8	-851.9
Total, unified budget outlays .....	2,655.4	2,784.3	2,901.9	2,985.5	3,049.1	3,157.3	3,246.3
<b>Surplus or deficit (-):</b>							
Federal funds .....	-537.3	-489.7	-533.3	-498.2	-428.9	-403.1	-296.7
Trust funds .....	289.1	245.6	293.9	311.1	334.5	349.3	357.7
Total, unified surplus/deficit (-) .....	-248.2	-244.2	-239.4	-187.2	-94.4	-53.8	61.0

Note: Receipts include governmental, interfund, and proprietary receipts. Receipts exclude intrafund receipts, which are offset against intrafund payments so that cash income and cash outgo of the fund group are not overstated.

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 each fund group net out all transactions that occur between funds within the same fund group.<sup>3</sup> These intrafund transactions constitute outgo and income for the individual funds that make and collect the payments, but they are offsetting for the fund group as a whole. The totals for each fund group measure only the group's transactions with the public and the other fund group. Second, income is computed net of the collections that are offset against outgo in revolving fund expenditure accounts.<sup>4</sup> It would be conceptually appropriate to classify these offsetting 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

<sup>3</sup>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.

<sup>4</sup>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.

fund of the Treasury.<sup>5</sup> 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. 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.

<sup>5</sup>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).

**Table 22-2. INCOME, OUTGO, AND BALANCES OF TRUST FUNDS GROUP**

(In billions of dollars)

	2006 Actual	Estimate					
		2007	2008	2009	2010	2011	2012
<b>Total Trust Funds</b>							
Balance, start of year .....	3,148.5	3,437.5	3,683.1	3,976.7	4,287.8	4,622.3	4,971.6
Income:							
Governmental receipts .....	891.5	929.4	985.3	1,025.7	1,082.0	1,139.6	1,193.8
Proprietary receipts .....	83.2	96.3	98.7	104.1	111.2	118.6	127.0
Receipts from Federal funds:							
Interest .....	171.3	183.5	194.8	208.1	223.7	239.7	254.8
Other .....	334.6	353.3	377.0	393.0	417.9	448.9	476.8
Subtotal, income .....	1,480.7	1,562.5	1,655.8	1,730.8	1,834.7	1,946.8	2,052.4
Outgo:							
To the public .....	1189.5	1292.2	1357.7	1418.3	1498.7	1596.0	1692.9
Payments to Federal funds .....	2.1	24.8	4.2	1.5	1.5	1.6	1.8
Subtotal, outgo .....	1191.6	1317.0	1361.9	1419.8	1500.2	1597.5	1694.7
Change in fund balance:							
Surplus or deficit (-):							
Excluding interest .....	117.7	62.1	99.1	103.0	110.9	109.6	102.9
Interest .....	171.3	183.5	194.8	208.1	223.7	239.7	254.8
Subtotal, surplus or deficit (-) .....	289.1	245.6	293.9	311.1	334.5	349.3	357.7
Adjustments:							
Transfers/lapses (net) .....	*	*	-0.3	.....	.....	.....	.....
Other adjustments .....	*	*	*	.....	.....	.....	.....
Total, change in fund balance .....	289.1	245.6	293.6	311.1	334.5	349.3	357.7
Balance, end of year .....	3,437.5	3,683.1	3,976.7	4,287.8	4,622.3	4,971.6	5,329.4

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 2006, the gross total of all trust fund and Federal fund receipts with the net total of the 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 \$49 billion in 2006. Table 22–2, therefore, provides a more transparent 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, continuing a trend that has persisted over the past two decades. The size of the anticipated balances is unprecedented and results mainly from 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 increase by more than 150 percent by the year 2012,

**Table 22–3. RELATIONSHIP OF TOTAL FEDERAL FUND AND TRUST FUND RECEIPTS TO UNIFIED BUDGET RECEIPTS, FISCAL YEAR 2006**

(In billions of dollars)

Gross trust fund receipts .....	1,436.5
Gross Federal fund receipts .....	1,607.6
<b>Total of trust fund receipts and Federal fund receipts .....</b>	<b>3,044.1</b>
Deduct intrafund receipts (from funds within the same fund group):	
Trust intrafund receipts .....	–4.8
Federal intrafund receipts .....	–35.6
<b>Subtotal, intrafund receipts .....</b>	<b>–40.4</b>
<b>Total of trust funds cash income and Federal funds cash income .....</b>	<b>3,003.7</b>
Deduct offsetting receipts: <sup>1</sup>	
Trust fund receipts from Federal funds:	
Interest in receipt accounts .....	–169.3
General fund payment to Medicare Parts B and D .....	–162.6
Employing agencies' payments for pensions, Social Security, and Medicare .....	–49.7
General fund payments for unfunded liabilities of Federal employees retirement funds .....	–51.6
Transfer of taxation of Social Security and RRB benefits to OASDI, HI, and RRB .....	–33.5
Other receipts from Federal funds .....	–3.5
<b>Subtotal, trust fund receipts from Federal funds .....</b>	<b>–470.2</b>
Federal fund receipts from trust funds .....	–2.1
Proprietary receipts .....	–124.1
<b>Subtotal, offsetting receipts .....</b>	<b>–596.4</b>
<b>Unified budget receipts .....</b>	<b>2,407.3</b>

<sup>1</sup> 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

rising to \$5.3 trillion.<sup>6</sup> 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 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

<sup>6</sup>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 would slow the growth of aggregate trust fund balances in the short term, but in combination with other reforms to restore Social Security to solvency would have a positive effect on trust fund balances in the long run.

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 while maintaining an unchanged Federal fund deficit, so that the trust fund surplus reduces the unified budget deficit or increases the 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. As long as the increase in Government saving is not offset by a reduction in private saving, greater investment would increase future incomes and wealth, which would provide more real economic resources to support the benefits.

Table 22-4 shows estimates of income, outgo, and balances for 2006 through 2012 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 as a whole. Additional information for these and other trust funds can be found in the Status of Funds tables in the *Budget Appendix*.

Table 22-5 shows income, outgo, and balances of five Federal funds—three revolving funds and two special funds. 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.

Table 22-4. INCOME, OUTGO, AND BALANCES OF MAJOR TRUST FUNDS

(In billions of dollars)

	2006 Actual	Estimate					
		2007	2008	2009	2010	2011	2012
<b>Airport and Airway Trust Fund</b>							
Balance, start of year .....	11.3	10.3	10.2	8.6	9.2	10.2	11.5
Income:							
Governmental receipts .....	10.6	11.4	12.1	4.3	4.7	5.1	5.5
Proprietary receipts .....	0.1	*	*	*	*	*	*
Receipts from Federal funds:							
Interest .....	0.5	0.5	0.5	0.4	0.4	0.4	0.4
Other .....	*	0.2	*	*	*	*	0.1
Receipts from Trust funds .....							
Subtotal, income .....	11.2	12.1	12.6	4.8	5.1	5.5	5.9
Outgo:							
To the public .....	12.1	12.3	14.2	4.2	4.1	4.2	4.3
Payments to Other funds .....							
Subtotal, outgo .....	12.1	12.3	14.2	4.2	4.1	4.2	4.3
Change in fund balance:							
Surplus or deficit (-):							
Excluding interest .....	-1.4	-0.7	-2.0	0.2	0.6	0.9	1.2
Interest .....	0.5	0.5	0.5	0.4	0.4	0.4	0.4
Subtotal, surplus or deficit (-) .....	-1.0	-0.2	-1.5	0.6	1.0	1.3	1.6
Adjustments:							
Transfers/lapses (net) .....							
Other adjustments .....							
Total, change in fund balance .....	-1.0	-0.2	-1.5	0.6	1.0	1.3	1.6
Balance, end of year .....	10.3	10.2	8.6	9.2	10.2	11.5	13.2
<b>Memorandum commitments against balance, end of year:</b>							
Obligated balances .....	7.6	6.5	3.9	5.0	5.5	5.6	5.6
Unobligated balances .....	1.0	1.7	1.6	0.4			
Total commitments .....	8.6	8.2	5.5	5.4	5.5	5.6	5.6
Uncommitted balance, end of year .....	1.8	2.0	3.1	3.8	4.7	5.9	7.5
<b>Federal Civilian Employees Retirement Funds</b>							
Balance, start of year .....	674.8	704.5	716.9	754.5	793.5	835.0	878.4
Income:							
Governmental receipts .....	4.3	4.7	4.6	4.8	4.9	5.0	5.0
Proprietary receipts .....							
Receipts from Federal funds:							
Interest .....	37.2	42.9	44.6	45.5	46.6	47.0	46.3
Other .....	46.9	50.1	53.4	56.2	59.7	63.3	67.4
Receipts from Trust funds .....							
Subtotal, income .....	88.5	97.7	102.6	106.5	111.1	115.2	118.6
Outgo:							
To the public .....	58.7	62.3	65.0	67.4	69.7	71.8	74.0
Payments to Other funds .....		23.0 <sup>1</sup>					
Subtotal, outgo .....	58.7	85.3	65.0	67.4	69.7	71.8	74.0
Change in fund balance:							
Surplus or deficit (-):							
Excluding interest .....	-7.5	-30.5	-7.0	-6.5	-5.1	-3.6	-1.6
Interest .....	37.2	42.9	44.6	45.5	46.6	47.0	46.3
Subtotal, surplus or deficit (-) .....	29.7	12.4	37.6	39.0	41.4	43.4	44.6
Adjustments:							
Transfers/lapses (net) .....							
Other adjustments .....		*	*				

Table 22-4. INCOME, OUTGO, AND BALANCES OF MAJOR TRUST FUNDS—Continued

(In billions of dollars)

	2006 Actual	Estimate					
		2007	2008	2009	2010	2011	2012
Total, change in fund balance .....	29.7	12.4	37.6	39.0	41.4	43.4	44.6
Balance, end of year .....	704.5	716.9	754.5	793.5	835.0	878.4	923.0
<b>Federal Employees Health Benefits Fund</b>							
Balance, start of year .....	12.5	14.8	16.4	17.1	17.7	18.4	19.4
Income:							
Governmental receipts .....							
Proprietary receipts .....	9.1	9.4	10.0	10.7	11.6	12.6	13.5
Receipts from Federal funds:							
Interest .....	0.6	0.7	0.7	0.8	0.8	0.8	0.9
Other .....	23.9	24.7	26.3	28.1	30.2	32.7	34.8
Receipts from Trust funds .....							
Subtotal, income .....	33.5	34.8	37.1	39.6	42.6	46.1	49.1
Outgo:							
To the public .....	31.3	33.2	36.4	39.0	41.9	45.0	48.3
Payments to Other funds .....							
Subtotal, outgo .....	31.3	33.2	36.4	39.0	41.9	45.0	48.3
Change in fund balance:							
Surplus or deficit (-):							
Excluding interest .....	1.7	0.9	-*	-0.1	-0.2	0.2	-*
Interest .....	0.6	0.7	0.7	0.8	0.8	0.8	0.9
Subtotal, surplus or deficit (-) .....	2.3	1.6	0.7	0.6	0.7	1.1	0.8
Adjustments:							
Transfers/lapses (net) .....							
Other adjustments .....							
Total, change in fund balance .....	2.3	1.6	0.7	0.6	0.7	1.1	0.8
Balance, end of year .....	14.8	16.4	17.1	17.7	18.4	19.4	20.3
<b>Foreign Military Sales Trust Fund</b>							
Balance, start of year .....	6.7	7.9	7.9	7.9	7.9	7.9	7.9
Income:							
Governmental receipts .....							
Proprietary receipts .....	14.2	15.1	13.1	11.4	11.7	11.9	12.1
Receipts from Federal funds:							
Interest .....							
Other .....							
Receipts from Trust funds .....							
Subtotal, income .....	14.2	15.1	13.1	11.4	11.7	11.9	12.1
Outgo:							
To the public .....	13.0	15.1	13.1	11.4	11.7	11.9	12.1
Payments to Other funds .....							
Subtotal, outgo .....	13.0	15.1	13.1	11.4	11.7	11.9	12.1
Change in fund balance:							
Surplus or deficit (-):							
Excluding interest .....	1.2						
Interest .....							
Subtotal, surplus or deficit (-) .....	1.2						
Adjustments:							
Transfers/lapses (net) .....							
Other adjustments .....							
Total, change in fund balance .....	1.2						

Table 22-4. INCOME, OUTGO, AND BALANCES OF MAJOR TRUST FUNDS—Continued

(In billions of dollars)

	2006 Actual	Estimate					
		2007	2008	2009	2010	2011	2012
Balance, end of year .....	7.9	7.9	7.9	7.9	7.9	7.9	7.9
<b>Highway Trust Fund</b>							
Balance, start of year .....	12.5	15.1	15.8	12.2	6.8	*	-7.0
Income:							
Governmental receipts .....	38.4	39.7	40.9	41.9	42.7	43.3	43.9
Proprietary receipts .....	*	*	*	*	*	*	*
Receipts from Federal funds:							
Interest .....							
Other .....	0.1	0.1	0.2	0.1	0.1	0.2	0.2
Receipts from Trust funds .....							
Subtotal, Income .....	38.5	39.9	41.0	42.1	42.8	43.5	44.1
Outgo:							
To the public .....	36.0	39.1	44.4	47.4	49.7	50.5	51.6
Payments to Other funds .....							
Subtotal, Outgo .....	36.0	39.1	44.4	47.4	49.7	50.5	51.6
Change in fund balance:							
Surplus or deficit:							
Excluding interest .....	2.5	0.7	-3.3	-5.4	-6.8	-7.0	-7.5
Interest .....							
Subtotal, surplus or deficit .....	2.5	0.7	-3.3	-5.4	-6.8	-7.0	-7.5
Adjustments:							
Transfers/lapses (net) .....	-*	-*	-0.3				
Other adjustments .....							
Total, Change in fund balance .....	2.5	0.7	-3.6	-5.4	-6.8	-7.0	-7.5
Balance, End of Year .....	15.1	15.8	12.2	6.8	*	-7.0	-14.5
<b>Medicare: Hospital Insurance (HI) Trust Fund</b>							
Balance, start of year .....	277.7	303.1	316.0	338.8	362.8	391.4	417.3
Income:							
Governmental receipts .....	177.7	185.5	199.0	209.0	221.5	234.1	246.1
Proprietary receipts .....	4.7	5.0	5.2	5.4	5.7	6.0	6.3
Receipts from Federal funds:							
Interest .....	15.4	15.2	16.0	17.5	18.8	20.3	21.9
Other .....	14.5	15.3	17.2	18.4	20.2	22.2	24.2
Receipts from Trust funds .....							
Subtotal, income .....	212.4	221.0	237.4	250.4	266.3	282.6	298.4
Outgo:							
To the public .....	186.9	208.1	214.6	226.3	237.7	256.7	260.7
Payments to Other funds .....		*	*	*	*	*	0.1
Subtotal, outgo .....	186.9	208.2	214.6	226.3	237.7	256.7	260.8
Change in fund balance:							
Surplus or deficit (-):							
Excluding interest .....	10.1	-2.4	6.8	6.5	9.8	5.6	15.7
Interest .....	15.4	15.2	16.0	17.5	18.8	20.3	21.9
Subtotal, surplus or deficit (-) .....	25.5	12.8	22.8	24.1	28.6	25.9	37.6
Adjustments:							
Transfers/lapses (net) .....							
Other adjustments .....	-*						
Total, change in fund balance .....	25.5	12.8	22.8	24.1	28.6	25.9	37.6
Balance, end of year .....	303.1	316.0	338.8	362.8	391.4	417.3	455.0



Table 22-4. INCOME, OUTGO, AND BALANCES OF MAJOR TRUST FUNDS—Continued

(In billions of dollars)

	2006 Actual	Estimate					
		2007	2008	2009	2010	2011	2012
<b>Medicare: Supplementary Medical Insurance (SMI) Trust Fund</b>							
Balance, start of year .....	16.9	33.3	41.9	48.2	51.6	54.0	51.1
Income:							
Governmental receipts .....							
Proprietary receipts .....	47.2	59.2	63.6	69.0	74.5	80.5	87.5
Receipts from Federal funds:							
Interest .....	1.5	2.0	2.5	2.7	2.9	3.0	3.2
Other .....	162.6	175.7	186.1	194.2	206.9	224.0	237.9
Receipts from Trust funds .....							
Subtotal, income .....	211.3	236.8	252.2	266.0	284.4	307.6	328.6
Outgo:							
To the public .....	194.9	228.2	245.9	262.5	282.0	310.5	319.8
Payments to Other funds .....		*	*	*	*	*	0.1
Subtotal, outgo .....	194.9	228.2	245.9	262.5	282.0	310.5	319.9
Change in fund balance:							
Surplus or deficit (-):							
Excluding interest .....	14.9	6.6	3.8	0.7	-0.5	-6.0	5.5
Interest .....	1.5	2.0	2.5	2.7	2.9	3.0	3.2
Subtotal, surplus or deficit (-) .....	16.4	8.6	6.3	3.4	2.4	-2.9	8.6
Adjustments:							
Transfers/lapses (net) .....							
Other adjustments .....	*						
Total, change in fund balance .....	16.4	8.6	6.3	3.4	2.4	-2.9	8.6
Balance, end of year .....	33.3	41.9	48.2	51.6	54.0	51.1	59.8
<b>Military Retirement Fund</b>							
Balance, start of year .....	194.7	206.0	214.2	221.7	229.1	237.0	245.7
Income:							
Governmental receipts .....							
Proprietary receipts .....							
Receipts from Federal funds:							
Interest .....	13.0	9.7	8.9	8.6	9.2	9.9	10.7
Other .....	39.4	42.2	44.3	46.4	48.1	50.0	51.7
Receipts from Trust funds .....							
Subtotal, income .....	52.4	51.9	53.2	55.0	57.4	59.9	62.4
Outgo:							
To the public .....	41.1	43.7	45.7	47.6	49.4	51.2	52.4
Payments to Other funds .....							
Subtotal, outgo .....	41.1	43.7	45.7	47.6	49.4	51.2	52.4
Change in fund balance:							
Surplus or deficit (-):							
Excluding interest .....	-1.7	-1.5	-1.4	-1.2	-1.3	-1.2	-0.6
Interest .....	13.0	9.7	8.9	8.6	9.2	9.9	10.7
Subtotal, surplus or deficit (-) .....	11.3	8.2	7.5	7.4	8.0	8.7	10.0
Adjustments:							
Transfers/lapses (net) .....							
Other adjustments .....							
Total, change in fund balance .....	11.3	8.2	7.5	7.4	8.0	8.7	10.0
Balance, end of year .....	206.0	214.2	221.7	229.1	237.0	245.7	255.7

Table 22-4. INCOME, OUTGO, AND BALANCES OF MAJOR TRUST FUNDS—Continued

(In billions of dollars)

	2006 Actual	Estimate					
		2007	2008	2009	2010	2011	2012
<b>Railroad Retirement Trust Funds</b>							
Balance, start of year .....	25.6	27.3	28.3	28.4	28.3	27.9	27.4
Income:							
Governmental receipts .....	4.2	4.4	4.5	4.7	4.7	4.8	5.0
Proprietary receipts .....	2.7	2.4	1.4	1.5	1.5	1.5	1.5
Receipts from Federal funds:							
Interest .....	*	0.1	0.1	0.1	0.1	0.1	0.1
Other .....	0.5	0.5	0.5	0.5	0.5	0.6	0.6
Receipts from Trust funds .....	4.8	5.2	5.3	5.4	5.7	6.2	6.0
Subtotal, income .....	12.2	12.5	11.8	12.1	12.5	13.1	13.1
Outgo:							
To the public .....	9.5	9.9	10.2	10.6	11.0	11.4	11.8
Payments to Other funds .....	1.1	1.5	1.6	1.6	1.8	2.2	1.8
Subtotal, outgo .....	10.6	11.4	11.8	12.2	12.8	13.6	13.6
Change in fund balance:							
Surplus or deficit (-):							
Excluding interest .....	1.5	1.0	—*	-0.2	-0.4	-0.6	-0.6
Interest .....	*	0.1	0.1	0.1	0.1	0.1	0.1
Subtotal, surplus or deficit (-) .....	1.6	1.1	*	-0.1	-0.3	-0.6	-0.5
Adjustments:							
Transfers/lapses (net) .....	*	*	*	.....	.....	.....	.....
Other adjustments .....	.....	.....	.....	.....	.....	.....	.....
Total, change in fund balance .....	1.6	1.1	*	-0.1	-0.3	-0.6	-0.5
Balance, end of year .....	27.3	28.3	28.4	28.3	27.9	27.4	26.9
<b>Social Security: Old-Age, Survivors and Disability Insurance (OASDI) Trust Funds</b>							
Balance, start of year .....	1,809.0	1,994.2	2,179.6	2,388.9	2,616.4	2,862.6	3,129.0
Income:							
Governmental receipts .....	608.4	634.1	674.1	711.4	753.3	795.8	835.3
Proprietary receipts .....	*	0.1	0.1	0.1	0.1	0.1	0.1
Receipts from Federal funds:							
Interest .....	97.7	106.2	114.6	124.8	136.5	149.3	162.1
Other .....	33.7	31.6	33.1	35.9	39.0	42.9	46.6
Receipts from Trust funds .....	.....	.....	.....	.....	.....	.....	.....
Subtotal, income .....	739.8	772.1	821.8	872.1	928.8	988.0	1,044.1
Outgo:							
To the public .....	549.6	581.8	607.7	639.8	677.6	716.5	789.6
Payments to Other funds .....	5.1	4.8	4.8	4.9	5.0	5.1	5.3
Subtotal, outgo .....	554.6	586.6	612.6	644.7	682.6	721.7	795.0
Change in fund balance:							
Surplus or deficit (-):							
Excluding interest .....	87.5	79.2	94.7	102.6	109.7	117.1	87.1
Interest .....	97.7	106.2	114.6	124.8	136.5	149.3	162.1
Subtotal, surplus or deficit (-) .....	185.2	185.5	209.3	227.4	246.2	266.4	249.2
Adjustments:							
Transfers/lapses (net) .....	.....	.....	.....	.....	.....	.....	.....
Other adjustments .....	.....	.....	.....	.....	.....	.....	.....
Total, change in fund balance .....	185.2	185.5	209.3	227.4	246.2	266.4	249.2
Balance, end of year .....	1,994.2	2,179.6	2,388.9	2,616.4	2,862.6	3,129.0	3,378.2

Table 22-4. INCOME, OUTGO, AND BALANCES OF MAJOR TRUST FUNDS—Continued

(In billions of dollars)

	2006 Actual	Estimate					
		2007	2008	2009	2010	2011	2012
<b>Unemployment Trust Fund</b>							
Balance, start of year .....	54.8	66.6	79.8	91.9	103.3	113.8	123.9
Income:							
Governmental receipts .....	43.4	45.0	45.2	44.6	45.3	46.3	47.6
Proprietary receipts .....	*	*	*	0.6	0.6	0.5	0.5
Receipts from Federal funds:							
Interest .....	2.7	3.3	3.9	4.6	5.1	5.5	5.9
Other .....	0.8	0.8	0.8	0.8	0.8	0.8	0.8
Receipts from Trust funds .....							
Subtotal, income .....	47.0	49.1	50.0	50.6	51.8	53.2	54.8
Outgo:							
To the public .....	35.2	35.8	37.8	39.2	41.3	43.1	44.8
Payments to Other funds .....							
Subtotal, outgo .....	35.2	35.8	37.8	39.2	41.3	43.1	44.8
Change in fund balance:							
Surplus or deficit (-):							
Excluding interest .....	9.1	10.0	8.2	6.9	5.4	4.5	4.2
Interest .....	2.7	3.3	3.9	4.6	5.1	5.5	5.9
Subtotal, surplus or deficit (-) .....	11.7	13.3	12.1	11.4	10.5	10.0	10.0
Adjustments:							
Transfers/lapses (net) .....	—*	—*	—*				
Other adjustments .....							
Total, change in fund balance .....	11.7	13.2	12.1	11.4	10.5	10.0	10.0
Balance, end of year .....	66.6	79.8	91.9	103.3	113.8	123.9	133.9
<b>Veterans Life Insurance Trust Funds</b>							
Balance, start of year .....	12.6	12.2	11.7	11.2	10.6	9.9	9.2
Income:							
Governmental receipts .....							
Proprietary receipts .....	0.5	0.5	0.5	0.4	0.4	0.4	0.3
Receipts from Federal funds:							
Interest .....	0.8	0.7	0.7	0.6	0.6	0.5	0.5
Other .....	*	*	*	*	*	*	*
Receipts from Trust funds .....							
Subtotal, income .....	1.3	1.2	1.1	1.1	1.0	0.9	0.8
Outgo:							
To the public .....	1.7	1.7	1.7	1.7	1.6	1.6	1.6
Payments to Other funds .....							
Subtotal, outgo .....	1.7	1.7	1.7	1.7	1.6	1.6	1.6
Change in fund balance:							
Surplus or deficit (-):							
Excluding interest .....	-1.2	-1.2	-1.2	-1.2	-1.3	-1.2	-1.2
Interest .....	0.8	0.7	0.7	0.6	0.6	0.5	0.5
Subtotal, surplus or deficit (-) .....	-0.4	-0.5	-0.5	-0.6	-0.7	-0.7	-0.7
Adjustments:							
Transfers/lapses (net) .....							
Other adjustments .....	—*	*	*				
Total, change in fund balance .....	-0.4	-0.5	-0.5	-0.6	-0.7	-0.7	-0.7
Balance, end of year .....	12.2	11.7	11.2	10.6	9.9	9.2	8.5

Table 22-4. INCOME, OUTGO, AND BALANCES OF MAJOR TRUST FUNDS—Continued

(In billions of dollars)

	2006 Actual	Estimate					
		2007	2008	2009	2010	2011	2012
<b>Other Trust Funds</b>							
Balance, start of year .....	39.4	42.4	44.4	47.4	50.6	54.1	57.8
Income:							
Governmental receipts .....	4.4	4.6	4.9	5.0	5.1	5.3	5.4
Proprietary receipts .....	4.6	4.7	4.8	4.9	5.0	5.1	5.3
Receipts from Federal funds:							
Interest .....	2.0	2.1	2.3	2.5	2.7	2.9	3.0
Other .....	12.2	12.1	15.2	12.3	12.2	12.2	12.5
Receipts from Trust funds .....							
Receipts adjustments .....							
Subtotal, income .....	23.2	23.6	27.2	24.6	25.0	25.5	26.2
Outgo:							
To the public .....	19.5	20.8	21.1	21.1	21.1	21.5	21.9
Payments to Other funds .....	0.7	0.7	3.1	0.3	0.4	0.4	0.4
Subtotal, outgo .....	20.2	21.5	24.2	21.4	21.5	21.9	22.3
Change in fund balance:							
Surplus or deficit (-):							
Excluding interest .....	1.0	-0.1	0.7	0.7	0.9	0.8	0.9
Interest .....	2.0	2.1	2.3	2.5	2.7	2.9	3.0
Subtotal, surplus or deficit (-) .....	3.0	2.1	3.0	3.2	3.5	3.6	3.9
Adjustments:							
Transfers/lapses (net) .....	*	*	*				
Other adjustments .....	-*	-*	-*				
Total, change in fund balance .....	3.0	2.1	3.0	3.2	3.5	3.6	3.9
Balance, end of year .....	42.4	44.4	47.4	50.6	54.1	57.8	61.6

<sup>1</sup> This amount reflects a payment from the Civil Service Retirement and Disability Fund to the newly-created Postal Service Retiree Health Benefits Fund at the Office of Personnel Management as required by the Postal Accountability and Enhancement Act (P.L. 109-435).

\* \$50 million or less.

Note: Balances shown include committed and uncommitted cash balances.

Table 22-5. INCOME, OUTGO, AND BALANCES OF SELECTED FEDERAL FUNDS

(In billions of dollars)

	2006 Actual	Estimate					
		2007	2008	2009	2010	2011	2012
<b>Abandoned Mine Reclamation Fund</b>							
Balance, start of year .....	2.1	2.3	2.4	2.5	2.5	2.6	2.7
Income:							
Governmental receipts .....	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Proprietary receipts .....							
Receipts from Federal funds:							
Interest .....	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Other .....							
Receipts from Trust funds .....							
Subtotal, income .....	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Outgo:							
To the public .....	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Payments to Other funds .....							
Subtotal, outgo .....	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Change in fund balance:							
Surplus or deficit (-):							
Excluding interest .....	*	*	-*	-0.1	-0.1	-*	-0.1
Interest .....	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Subtotal, surplus or deficit (-) .....	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Adjustments:							
Transfers/lapses (net) .....							
Other adjustments .....							
Total, change in fund balance .....	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Balance, end of year .....	2.3	2.4	2.5	2.5	2.6	2.7	2.8
<b>National Credit Union Share Insurance Fund</b>							
Balance, start of year .....	6.4	6.7	7.0	7.5	7.9	8.3	8.8
Income:							
Governmental receipts .....							
Proprietary receipts .....	0.1	0.2	0.2	0.2	0.2	0.2	0.2
Receipts from Federal funds:							
Interest .....	0.2	0.3	0.3	0.3	0.3	0.3	0.4
Other .....	*						
Receipts from Trust funds .....							
Subtotal, income .....	0.4	0.5	0.5	0.6	0.5	0.6	0.6
Outgo:							
To the public .....	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Payments to Other funds .....							
Subtotal, outgo .....	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Change in fund balance:							
Surplus or deficit (-):							
Excluding interest .....	*	0.1	0.1	0.1	0.1	0.1	0.1
Interest .....	0.2	0.3	0.3	0.3	0.3	0.3	0.4
Subtotal, surplus or deficit (-) .....	0.3	0.4	0.4	0.5	0.4	0.4	0.5
Adjustments:							
Transfers/lapses (net) .....							
Other adjustments .....							
Total, change in fund balance .....	0.3	0.4	0.4	0.5	0.4	0.4	0.5
Balance, end of year .....	6.7	7.0	7.5	7.9	8.3	8.8	9.2

Table 22-5. INCOME, OUTGO, AND BALANCES OF SELECTED FEDERAL FUNDS—Continued

(In billions of dollars)

	2006 Actual	Estimate					
		2007	2008	2009	2010	2011	2012
<b>Overseas Private Investment Corporation</b>							
Balance, start of year .....	4.0	4.2	4.3	4.4	4.6	4.8	4.9
Income:							
Governmental receipts .....							
Proprietary receipts .....	0.1	*	*	*	*	*	*
Receipts from Federal funds:							
Interest .....	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Other .....	*	*	*	*	*	*	*
Receipts from Trust funds .....							
Subtotal, income .....	0.3	0.2	0.3	0.3	0.3	0.3	0.3
Outgo:							
To the public .....	*	0.1	0.1	0.1	0.1	0.1	0.1
Payments to Other funds .....							
Subtotal, outgo .....	*	0.1	0.1	0.1	0.1	0.1	0.1
Change in fund balance:							
Surplus or deficit (-):							
Excluding interest .....	0.1	-0.1	-*	-*	-0.1	-*	-*
Interest .....	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Subtotal, surplus or deficit (-) .....	0.3	0.1	0.2	0.2	0.2	0.2	0.2
Adjustments:							
Transfers/lapses (net) .....	-*	-*	-0.1				
Other adjustments .....							
Total, change in fund balance .....	0.2	0.1	0.1	0.2	0.2	0.2	0.2
Balance, end of year .....	4.2	4.3	4.4	4.6	4.8	4.9	5.1
<b>Pension Benefit Guaranty Corporation</b>							
Balance, start of year .....	12.5	15.1	14.8	13.7	14.6	15.6	16.5
Income:							
Governmental receipts .....							
Proprietary receipts .....	3.2	3.8	3.5	6.5	7.5	7.9	8.5
Receipts from Federal funds:							
Interest .....	3.9	0.7	0.7	0.7	0.8	0.8	0.8
Other .....							
Receipts from Trust funds .....							
Subtotal, income .....	7.1	4.5	4.2	7.2	8.2	8.7	9.3
Outgo:							
To the public .....	4.4	4.8	5.3	6.3	7.2	7.8	8.4
Payments to Other funds .....							
Subtotal, outgo .....	4.4	4.8	5.3	6.3	7.2	7.8	8.4
Change in fund balance:							
Surplus or deficit (-):							
Excluding interest .....	-1.3	-1.0	-1.8	0.2	0.3	0.1	0.1
Interest .....	3.9	0.7	0.7	0.7	0.8	0.8	0.8
Subtotal, surplus or deficit (-) .....	2.6	-0.3	-1.1	1.0	1.0	0.9	0.9
Adjustments:							
Transfers/lapses (net) .....							
Other adjustments .....							
Total, change in fund balance .....	2.6	-0.3	-1.1	1.0	1.0	0.9	0.9
Balance, end of year .....	15.1	14.8	13.7	14.6	15.6	16.5	17.4

Table 22-5. INCOME, OUTGO, AND BALANCES OF SELECTED FEDERAL FUNDS—Continued

(In billions of dollars)

	2006 Actual	Estimate					
		2007	2008	2009	2010	2011	2012
<b>Uniformed services retiree health care fund</b>							
Balance, start of year .....	60.2	84.7	108.1	132.2	158.6	187.1	218.1
Income:							
Governmental receipts .....	.....	.....	.....	.....	.....	.....	.....
Proprietary receipts .....	.....	.....	.....	.....	.....	.....	.....
Receipts from Federal funds:							
Interest .....	3.8	3.8	5.0	6.3	7.8	9.4	11.1
Other .....	27.8	27.2	27.4	29.0	30.4	32.0	33.5
Receipts from Trust funds .....	.....	.....	.....	.....	.....	.....	.....
Subtotal, Income .....	31.5	31.0	32.4	35.3	38.2	41.4	44.6
Outgo:							
To the public .....	7.1	7.7	8.3	8.9	9.7	10.4	11.3
Payments to Other funds .....	.....	.....	.....	.....	.....	.....	.....
Subtotal, Outgo .....	7.1	7.7	8.3	8.9	9.7	10.4	11.3
Change in fund balance:							
Surplus or deficit:							
Excluding interest .....	20.7	19.5	19.1	20.1	20.8	21.5	22.2
Interest .....	3.8	3.8	5.0	6.3	7.8	9.4	11.1
Subtotal, surplus or deficit .....	24.5	23.3	24.1	26.4	28.5	30.9	33.3
Adjustments:							
Transfers/lapses (net) .....	.....	0.2	.....	.....	.....	.....	.....
Other adjustments .....	.....	.....	.....	.....	.....	.....	.....
Total, Change in fund balance .....	24.5	23.5	24.1	26.4	28.5	30.9	33.3
Balance, End of Year .....	84.7	108.1	132.2	158.6	187.1	218.1	251.4

\* \$50 million or less.

Note: Balances shown include committed and uncommitted cash balances.





## 23. OFF-BUDGET FEDERAL ENTITIES AND NON-BUDGETARY ACTIVITIES

The Federal Government's activities have far-reaching impacts, affecting the economy and society of the Nation and the world. One of the primary activities of the Government is to allocate resources to meet the Nation's needs. The budget is a financial plan for proposing, deciding, and controlling the allocation of resources by the Federal Government. Those Federal financial activities that affect the Government's allocation of resources in a measurable way are characterized as "budgetary."

Those Federal activities that do not involve the Government's direct allocation of resources are characterized as "non-budgetary" and classified outside of the budget. For example, the budget does not include funds that are privately owned, such as the deposit funds owned by Native American Indians, even though those funds are held and managed by the Government in a fiduciary capacity. In addition, the budget does not include costs that are borne by the private sector rather than the Government even though those costs result from Federal activity, such as regulatory activity. Also, the budget includes the subsidy costs of Federal loan programs, but excludes other cash flows related to these programs because they do not reflect an allocation of resources, as explained below. 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.

The term "off-budget" may appear to be synonymous with "non-budgetary." However, the term "off-budget" has a meaning distinct from "non-budgetary" and refers to Federal Government activities that are required by law to be excluded from the budget totals. The "unified" budget of the Federal Government reflects this legal distinction between "on-budget" and "off-budget" entities by showing outlays and receipts for both types of entities separately. Although there is a legal distinction between on-budget and off-budget entities, there is no conceptual difference between the two. The off-budget Federal entities engage in the same basic activities of government as the on-budget entities and off-budget spending channels economic resources toward particular uses in the same way as does on-budget spending. The unified budget reflects the conceptual similarity between on-budget and off-budget entities by showing outlays and receipts for both types of entities combined. Off-budget spending and receipts are discussed further in the following section on off-budget Federal entities.

### 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 that would otherwise be included in the budget has been declared to be off-budget by law. Such 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 by law, 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. Federal entities that are off-budget by law are distinct from entities that are non-budgetary, as discussed below.

Off-budget Federal entities conduct programs of the same type as on-budget entities, and the programs they conduct result in the same kind of spending and receipts as on-budget entities. For this reason, most of the tables in the budget include both on-budget and off-budget amounts separately and in combination, or as a total amount.

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 that had been declared off-budget by law at different times before 1986 have been classified on-budget by law since at least 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.

Because Social Security is off-budget, the off-budget accounts comprise a significant part of total Federal spending and receipts. In 2008, off-budget receipts are an estimated 25 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 2008 is \$239 billion—a \$451 billion on-budget deficit partly offset by a \$212 billion off-budget surplus. The off-budget surplus consists almost en-

tirely 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 within approximately ten years and never reach balance again. The long-term challenge of Social Security is addressed briefly in a chapter of the main *Budget* volume, "The Nation's Fiscal Outlook," and in Chapter 13 of this volume, "Stewardship."

### Non-Budgetary Activities

Some important Federal activities are characterized as non-budgetary because they do not involve the allocation of resources by the Federal Government or they allocate resources in a way that is indirect. The Budget does not reflect these indirect economic and financial effects.

**Federal credit: budgetary and non-budgetary transactions.**—Federal credit programs make direct

loans or guarantee private loans. The Federal Credit Reform Act of 1990 refined how the costs of credit programs are recorded in the budget by defining as budgetary the subsidies provided by the credit programs and classifying the other credit cash flows as non-budgetary.

When the Government makes a loan, it generates a financial asset that will produce future cash inflows for the Government as the loan is repaid. When the Government guarantees a loan made by a non-Federal lender, it acquires a contingent liability that may require a cash outflow in a future year. Prior to the Credit Reform Act, the budget treated the full amount of a Federal loan as a cost and an outlay at the time the loan was made, and treated the future repayments of principal and interest as receipts. Similarly, the budget did not record the cash outflows for loan guarantees as a cost and an outlay until the loan defaulted, and the Government had to fulfill its guarantee commitment.

TABLE 23-1. COMPARISON OF TOTAL, ON-BUDGET, AND OFF-BUDGET TRANSACTIONS <sup>1</sup>

(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	2,407.3	1,798.9	608.4	2,655.4	2,233.4	422.1	-248.2	-434.5	186.3
2007 estimate	2,540.1	1,906.0	634.1	2,784.3	2,333.0	451.3	-244.2	-427.0	182.8
2008 estimate	2,662.5	1,988.4	674.1	2,901.9	2,439.3	462.5	-239.4	-450.9	211.6
2009 estimate	2,798.3	2,086.9	711.4	2,985.5	2,499.7	485.8	-187.2	-412.7	225.6
2010 estimate	2,954.7	2,201.4	753.3	3,049.1	2,540.5	508.6	-94.4	-339.1	244.7
2011 estimate	3,103.6	2,307.8	795.8	3,157.3	2,625.8	531.5	-53.8	-318.0	264.3
2012 estimate	3,307.3	2,472.0	835.3	3,246.3	2,659.1	587.2	61.0	-187.1	248.1

<sup>1</sup> Off-budget transactions consist of the Social Security trust funds and the Postal Service fund.

Under the Credit Reform Act, beginning in 1992, the budgetary costs of direct loans and loan guarantees are measured as the net present value of estimated cash outflows from the Government less the present value of estimated cash inflows to the Government. The cash flows are discounted at the Government's cost of borrowing. The costs are recorded in the budget at the time the Government makes a loan or guarantees a loan made by a non-Federal lender. A group of loans that is expected to repay exactly what it costs the Government to finance would have zero net cost and, under the Credit Reform Act, no effect on Government outlays. The same is true for a group of non-Federal loans that is guaranteed by the Government and for which upfront fees offset the cost of defaults. However, if the Government provides a subsidy, by charging below-market interest rates or fees that are less than the cost of the defaults, or by paying interest subsidies to non-Federal lenders, the Government incurs a budgetary cost, which also is measured on a present value basis. This cost is similar to the net outlays of other Federal programs and, under the Credit Reform Act, is included in the budget as an outlay of a credit "program" account.

All of the cash transactions with the public that result from Government credit programs—the disbursement and repayment of loans, the payment of default claims on guarantees, and the collection of interest and fees—are recorded in credit "financing" accounts. These 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 or outlays to the Government. Therefore, the financing accounts are non-budgetary and excluded from the budget under the Credit Reform Act.<sup>1</sup> Transactions of the financing accounts do, however, affect the Government's borrowing requirements, as explained in Chapter 16 of this volume, "Federal Borrowing and Debt."

Since credit reform, the budget outlays of credit programs reflect only the subsidy costs of Government credit, thus measuring accurately the cost of credit decisions, and record this cost when the credit assistance is provided. This enables the budget to fulfill its purpose of being a financial plan for allocating resources among alternative uses by 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.<sup>2</sup> 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 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 Government Securities Investment Fund, which is also known as the G Fund. It is one of several investment funds managed by the Federal Retirement Thrift Investment Board, as an agent, for Federal employees who participate in the Government's defined contribution retirement plan, the Thrift Savings Plan (TSP). Because the G Fund assets, which are held by the Department of the Treasury, are the property of Federal employees and are held by the Government only in a fiduciary capacity, the transactions of the Fund are not transactions of the Government itself and are non-budgetary. The administrative functions of the Thrift Investment Board are carried out by Government employees, and are, therefore, included in the budget on a reimbursable basis. For similar reasons, the budget excludes funds that are owned by Native American Indians, but held and managed by the Government in a fiduciary capacity.

The Social Security voluntary personal retirement accounts proposed by the Administration would be owned by individuals, not the Government. If the proposal is adopted, contributions into the accounts will be recorded as outlays, but the accounts themselves would be non-budgetary. 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."

**Tax expenditures.**—The Federal tax system includes numerous special tax exclusions, exemptions, deductions, and similar provisions that have been added to the tax code over time. These provisions affect resource allocation and income distribution in ways that are similar to spending programs. Because of this similarity, these provisions are referred to as "tax expenditures." Unlike typical spending programs, however, tax expenditures reduce receipts rather than increase outlays. Measuring tax expenditures requires specifying a hypothetical "baseline" tax system, which as noted below can be highly subjective. Because of the subjectivity in determining what is a tax expenditure and because of the difficulties in measuring them, tax expenditures are treated as non-budgetary.

Tax expenditures are discussed in Chapter 19 of this volume, "Tax Expenditures." Chapter 19 presents estimates for tax expenditures associated with the individual and corporate income taxes, and discusses how tax expenditures compare with spending programs and regulation as alternative methods for achieving policy

<sup>1</sup> See §505(b) of the Federal Credit Reform Act of 1990.

<sup>2</sup> 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.

objectives. The chapter explains that the baseline concepts used to identify and measure tax expenditures are somewhat arbitrary. As the chapter notes, the magnitude and distribution of tax expenditures would be significantly different if measured relative to a comprehensive income tax or a comprehensive consumption tax. The current tax expenditure baseline is loosely patterned on a comprehensive income tax, but departs from that standard in a number of areas. The appendix to Chapter 19 provides a critique of the current tax expenditure presentation and attempts to answer three questions: (1) what would be tax expenditures if a comprehensive income tax were used as the baseline without any departures from such a standard; (2) what would be the tax expenditures if a comprehensive consumption tax were used to define the baseline; and (3) what are the negative tax expenditures under the current system. Negative tax expenditures are 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.

Hypothetically, tax expenditures could be included in the budget by measuring receipts as the sum of actual receipts plus tax expenditures receipts, and measuring outlays as the sum of actual outlays plus tax expenditures. The budget could then show the allocation of resources to education, housing or other purposes through the combined effect of tax expenditures and spending programs. Receipts and outlays would be increased by the same amount, so this change in display would have no impact on the deficit. However, as noted above, the difficulty in identifying and measuring tax expenditures makes it impractical to include tax expenditures in the budget.

**Government-sponsored enterprises.**—The Federal Government chartered several Government-sponsored enterprises (GSEs), such as Fannie Mae, Freddie Mac, and the Farm Credit Banks, to provide financial intermediation for specified public purposes. The GSEs are excluded from the budget because they are privately owned and controlled. However, because they were established by the Federal Government 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.**—Government regulation often requires the private sector to make expenditures for specified purposes, such as safety and pollution control. Although

the budget reflects the cost to the Government of conducting regulatory activities, the costs imposed on the private sector as a result of the regulation are treated as non-budgetary. The Government’s regulatory priorities and plans are described in the annual *Regulatory Plan* and the semi-annual *Unified Agenda of Federal Regulatory and Deregulatory Actions*.<sup>3</sup>

Although not included in the budget, the estimated costs and benefits of Federal regulation have been published annually by the Office of Management and Budget (OMB) since 1997. The latest report was released in January 2007.<sup>4</sup> The report estimates the total costs and benefits of major Federal regulations reviewed by OMB from October 1995 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, provides an update on various initiatives to improve regulatory cooperation internationally, provides an update on the status of regulatory reforms resulting from three public nomination initiatives in 2001, 2002, and 2004, and includes a report on Agency Compliance with the Unfunded Mandates Reform Act of 1995. The draft of the 2007 report will be published in February 2007 for public comment.

**Indirect Macroeconomic Effects of Federal Activity.**—Government activity has many effects on the Nation’s economy that extend beyond the amounts recorded in the budget. Government expenditures, taxation, tax expenditures, regulation and trade policy can all affect the allocation of resources among private uses and income distribution among individuals. These effects, resulting indirectly from Federal activity, are generally not part of the budget, but the most important of them are discussed in this volume and in the main *Budget* volume.

<sup>3</sup>The most recent *Regulatory Plan* and introduction to the *Unified Agenda* were issued by the General Services Administration’s Regulatory Information Service Center and were printed in the *Federal Register* of December 11, 2006 (vol. 71, no. 237). Both the *Regulatory Plan* and *Unified Agenda* are available on-line at [www.reginfo.gov](http://www.reginfo.gov) and at [www.gpoaccess.gov](http://www.gpoaccess.gov).

<sup>4</sup>Office of Information and Regulatory Affairs, Office of Management and Budget, *Validating Regulatory Analysis: 2006 Report to Congress on the Costs and Benefits of Federal Regulations and Unfunded Mandates on State, Local, and Tribal Entities* (2006).

## 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. New this year is a discussion on the full cost of military personnel.

### 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 85). 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 three percent between 2004 and 2008. The primary reason for this growth continues to be mission increases for homeland security and the global war on terrorism. Significant changes by agency are discussed below.

Within the *Department of Commerce*, the Bureau of the Census is preparing for the 2010 Census. Census will conduct a “dress rehearsal” in 2008. They will begin opening regional field offices to prepare for nationwide activities in 2009. Also, they will increase FTE for the data collection phase of the Economic Census. The U.S. Patent and Trademark Office requests additional FTE in an effort to decrease processing times for patent and trademark applications, both of which are increasing.

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 a change in the technical skills mix required for the National Nuclear Security Administration (NNSA). The NNSA aggressively shed staff several years ago and is now adding back personnel who are better suited to the current and future program of work.

The *Department of Health and Human Services* is requesting additional FTE due to increased activities in a number of program areas. The majority of the increase is due to the following: 1) Additional staff for the Food and Drug Administration’s generic drug review and post-market drug safety activities; 2) Expanded staff at Indian Health Service health care facilities; 3) Increases in activities related to improved bioterrorism and pandemic influenza preparedness; and 4) Increases in the Public Health Service Commissioned Corps to form two new Health and Medical Response (HAMR) Teams.

Within the *Department of Homeland Security*, Immigration and Customs Enforcement (ICE) has seen a

significant growth in its workforce as a part of the Administration’s efforts to increase border security and to improve interior enforcement of our Nation’s immigration laws. ICE has hired new detention and removal personnel to manage the significant growth in the number of detention beds and additional criminal investigators to increase worksite enforcement, to investigate visa overstays and to combat cross-border smuggling of aliens and goods. In addition, the United States Citizenship and Immigration Services is increasing adjudication and supporting staff as part of its effort to more effectively meet the increasing applications for immigration benefits and services. Lastly, there are increases for aviation and transportation security.

*Department of Justice* FTE increases are due to enhancements in critical law enforcement and counterterrorism related programs. The growth largely occurs within the Federal Prison System as a result of the growing federal prisoner population and in the Federal Bureau of Investigation as it continues its transformation to meet both its law enforcement and counterterrorism responsibilities.

*Department of Transportation’s* workforce growth largely comes from the Federal Aviation Administration (FAA). The FAA plans to increase its FTE for the “Air Traffic Organization” and “Safety and Operations” accounts in 2008 in order to annualize hiring made during 2006, increase personnel for the air traffic control and safety workforces, and implement new directives regarding contract oversight and homeland security.

The *Office of Personnel Management* has gained FTE as it completes the transfer of security investigative personnel from the Department of Defense to OPM.

### 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,

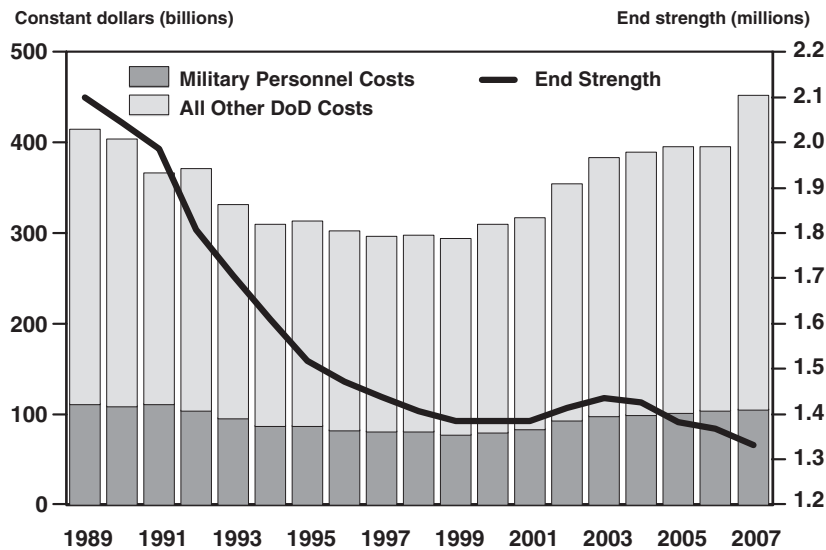
and other items. Compensation for former personnel includes outlays for retirement pay benefits and the Government's share of the cost of health and life insurance.

**Military Compensation**

Since 1989, military end strength has been decreasing, but the cost per person has steadily risen keeping

the percentage of defense spending devoted to military personnel at a near-constant level. In 1989, when there were 800,000 more active duty military personnel on duty, military personnel costs constituted 27 percent of the base budget. The percentage remains about 25 percent now.

**Chart 24-1. Post Cold War End Strength and Spending**



What has driven personnel costs higher?

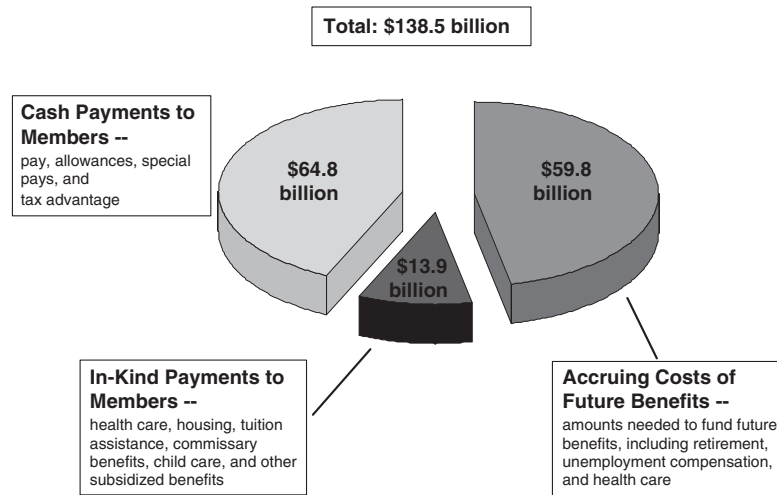
- Increased basic pay by more than 28 percent during this administration alone;
- Increased housing allowances to eliminate the average out-of-pocket housing costs (from approximately 18 percent in the mid-1990s to zero today) as well as the shift from set-percentage increases to the use of surveys to set housing rates;
- Increased health care benefits for both active and reserve forces (increased 95 percent between 2001 and 2005);
- Increased education benefits for both active and reserve forces;

- Increased moving allowances and full replacement value for damaged property;
- Increased post-service benefits, which are financed by investing current funds to ensure money is available in the future;
- Increased special pays and bonuses, and the expansion of eligible populations;
- Increased tax law exemptions to allow service members to claim the Earned Income Tax Credit.

The following chart depicts the average Fiscal Year 2005 peacetime cost to the government of employing service members:

### Chart 24-2. DoD Direct Compensation Costs

Fiscal Year 2005



Basic Data: Department of Defense Program Analysis and Evaluation.

In addition to these costs, the Department of Defense spends more than \$12 billion on non-compensation costs for service members and families for facilities, training, child education, and travel and more than \$42 billion for payments to retirees and survivors. The Department of Veterans Affairs spends nearly \$40 billion on medical care, vocational rehabilitation, compensation, pensions, education, home loans, burial and other services for as many as 70 million veterans and their families.

#### The U.S. Overseas Staffing Presence

There are over 65,000 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 to support an American position overseas in 2008 is projected to

be about \$505,000, as reported by agencies with personnel overseas. This total includes direct costs, such as salary, benefits, and overseas allowances, and also support costs, such as housing, educational costs for dependents, travel, administrative support, and Capital Security Cost Sharing charges.

The Administration continues to work to improve the safety, efficiency, and accountability in U.S. Government staffing overseas through the Presidential Management Agenda initiative on a Right-sized Overseas Presence. A component of this initiative is developing transparent data on overseas staffing, including the cost of maintaining positions overseas, and incorporating these data in the budget process to better inform decisions makers on overseas staffing levels.

#### Overseas Staffing Under Chief of Mission Authority\*

Total Personnel Overseas Under COM Authority (Including American and Locally Engaged Staff) Projected for 2007	Total American Personnel Overseas Under COM Authority Projected for 2007	Average Cost of a U.S. Direct Hire Overseas Estimated for 2008	New Overseas American Positions Funded in the President's 2008 Budget
65,250	15,400	\$505,000	148

\* As reported by agencies in their 2008 Budget submissions.

**Table 24-1. FEDERAL CIVILIAN EMPLOYMENT IN THE EXECUTIVE BRANCH**

(Civilian employment as measured by Full-Time Equivalents, in thousands)

Agency	Actual			Estimate		Change: 2004 to 2008	
	2004	2005	2006	2007	2008	FTE's	Percent
<b>Cabinet agencies:</b>							
Agriculture .....	100.5	99.6	97.0	96.9	92.2	-8.3	-8.3%
Commerce .....	34.6	35.1	36.0	37.3	40.7	6.1	17.6%
Defense-military functions .....	650.4	653.0	661.8	667.4	671.9	21.5	3.3%
Education .....	4.4	4.3	4.2	4.2	4.2	-0.2	-4.5%
Energy .....	15.1	14.9	14.7	15.5	16.0	0.9	6.0%
Health and Human Services .....	59.3	59.3	59.1	59.5	61.5	2.2	3.7%
Homeland Security .....	137.3	143.3	144.4	150.3	157.2	19.9	14.5%
Housing and Urban Development .....	10.2	9.9	9.6	9.2	9.5	-0.7	-6.9%
Interior .....	70.7	70.4	68.7	67.7	69.7	-1.0	-1.4%
Justice .....	101.4	103.0	104.2	117.6	112.6	11.2	11.0%
Labor .....	16.5	16.0	15.8	16.2	16.9	0.4	2.4%
State .....	30.0	30.1	30.0	30.6	30.9	0.9	3.0%
Transportation .....	57.3	55.5	53.3	54.4	55.1	-2.2	-3.8%
Treasury .....	113.6	110.0	107.7	108.4	109.0	-4.6	-4.0%
Veterans Affairs .....	218.7	222.0	222.6	225.4	226.5	7.8	3.6%
<b>Other agencies—excluding Postal Service:</b>							
Agency for International Development .....	2.2	2.4	2.4	2.5	2.5	0.3	13.6%
Broadcasting Board of Governors .....	2.3	2.2	2.1	2.2	2.2	-0.1	-4.3%
Corps of Engineers—Civil Works .....	23.5	22.5	22.1	21.7	21.3	-2.2	-9.4%
Environmental Protection Agency .....	17.3	17.5	17.3	17.5	17.3	.....	.....
Equal Employment Opportunity Commission .....	2.5	2.4	2.2	2.4	2.4	-0.1	-4.0%
Federal Deposit Insurance Corporation .....	5.3	4.9	4.5	4.7	4.7	-0.6	-11.3%
General Services Administration .....	12.6	12.5	12.3	12.3	12.3	-0.3	-2.4%
National Aeronautics and Space Administration .....	18.8	18.8	18.3	18.3	18.2	-0.6	-3.2%
National Archives and Records Administration .....	2.8	2.8	2.8	2.8	2.8	.....	.....
National Labor Relations Board .....	1.9	1.8	1.8	1.8	1.7	-0.2	-10.5%
National Science Foundation .....	1.3	1.3	1.3	1.3	1.4	0.1	7.7%
Nuclear Regulatory Commission .....	3.0	3.1	3.2	3.3	3.6	0.6	20.0%
Office of Personnel Management .....	2.8	3.6	4.3	4.9	4.9	2.1	75.0%
Peace Corps .....	1.1	1.0	1.1	1.2	1.1	.....	.....
Railroad Retirement Board .....	1.1	1.0	1.0	1.0	1.0	-0.1	-9.1%
Securities and Exchange Commission .....	3.6	3.9	3.7	3.6	3.6	.....	.....
Small Business Administration .....	3.4	4.1	5.9	3.2	3.2	-0.2	-5.9%
Smithsonian Institution .....	5.1	5.1	5.0	5.0	5.3	0.2	3.9%
Social Security Administration .....	63.9	64.6	63.7	59.9	59.8	-4.1	-6.4%
Tennessee Valley Authority .....	12.0	12.6	13.1	13.3	13.3	1.3	10.8%
All other small agencies .....	14.9	14.8	15.4	16.3	16.4	1.5	10.1%
<b>Total, Executive Branch civilian employment*</b> .....	<b>1,821.1</b>	<b>1,829.6</b>	<b>1,832.8</b>	<b>1,859.7</b>	<b>1,872.8</b>	<b>51.7</b>	<b>2.8%</b>
Subtotal, Defense .....	650.4	653.0	661.8	667.4	671.9	21.5	3.3%
Subtotal, Non-Defense .....	1,170.7	1,176.6	1,171.0	1,192.3	1,200.9	30.2	2.6%

\* 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: 2004 to 2006	
	2004	2005	2006	Positions	Percent
Executive branch civilian employment:					
All agencies except Postal Service and Postal Rate Commission:					
Full-time permanent .....	1,662,990	1,663,043	1,668,529	5,539	0.3%
Other than full-time permanent .....	218,953	209,157	211,474	-7,479	-3.4%
Subtotal .....	1,881,943	1,872,200	1,880,003	-1,940	-0.1%
Postal Service: <sup>1</sup>					
Full-time permanent .....	609,579	605,120	602,409	-7,170	-1.2%
Other than full-time permanent .....	158,083	159,090	155,058	-3,025	-1.9%
Subtotal .....	767,662	764,210	757,467	-10,195	-1.3%
Subtotal, Executive branch civilian employment .....	2,649,605	2,636,410	2,637,470	-12,135	-0.5%
Military personnel on active duty: <sup>2</sup>					
Department of Defense .....	1,426,836	1,389,394	1,384,968	-41,868	-2.9%
Department of Homeland Security (USCG) .....	40,230	40,710	41,145	915	2.3%
Commissioned Corps (EPA, HHS, NOAA) .....	6,357	6,363	6,240	-117	-1.8%
Subtotal, military personnel .....	1,473,423	1,436,467	1,432,353	-41,070	-2.8%
Subtotal, Executive Branch .....	4,123,028	4,072,877	4,069,823	-53,205	-1.3%
Legislative branch:					
Full-time permanent .....	11,614	11,389	11,165	-449	-3.9%
Other than full-time permanent .....	18,435	19,427	18,321	-114	-0.6%
Subtotal, Legislative Branch .....	30,049	30,816	29,486	-563	-1.9%
Judicial Branch:					
Full-time permanent .....	30,537	30,765	30,577	40	0.1%
Other than full-time permanent .....	3,324	3,299	3,183	-141	-4.2%
Subtotal, Judicial Branch .....	33,861	34,064	33,760	-101	-0.3%
<b>Grand total</b> <sup>3</sup> .....	<b>4,186,938</b>	<b>4,137,757</b>	<b>4,133,069</b>	<b>-53,869</b>	<b>-1.3%</b>
<b>ADDENDUM</b>					
Executive branch civilian personnel (excluding Postal Service):					
DOD civilians—Military functions .....	644,251	648,590	652,716	8,465	1.3%
All other executive branch .....	1,237,692	1,223,610	1,227,287	-10,405	-0.8%
<b>Total</b> .....	<b>1,881,943</b>	<b>1,872,200</b>	<b>1,880,003</b>	<b>-1,940</b>	<b>-0.1%</b>

<sup>1</sup> Includes Postal Rate Commission.<sup>2</sup> Excludes reserve components.<sup>3</sup> 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	2006 Actual	Estimate		Change: 2006 to 2008	
		2007	2008	FTE's	Percent
<b>Executive branch civilian personnel:</b>					
All agencies except Postal Service and Defense .....	1,171,021	1,192,286	1,200,873	29,852	2.5%
Defense-Military functions (civilians) .....	661,789	667,385	671,923	10,134	1.5%
Subtotal, excluding Postal Service .....	1,832,810	1,859,671	1,872,796	39,986	2.2%
Postal Service <sup>1</sup> .....	736,382	716,451	704,645	-31,737	-4.3%
Subtotal, Executive Branch civilian personnel .....	2,569,192	2,576,122	2,577,441	8,249	0.3%
<b>Executive branch uniformed personnel: <sup>2</sup></b>					
Department of Defense .....	1,384,968	1,378,084	1,369,350	-15,618	-1.1%
Department of Homeland Security (USCG) .....	41,145	41,715	41,997	852	2.1%
Commissioned Corps (HHS, EPA, NOAA) .....	6,240	6,337	6,603	363	5.8%
Subtotal, uniformed military personnel .....	1,432,353	1,426,136	1,417,950	-14,403	-1.0%
Subtotal, Executive Branch .....	4,001,545	4,002,258	3,995,391	-6,154	-0.2%
Legislative Branch: Total FTE <sup>3</sup> .....	31,294	32,408	32,813	1,519	4.9%
Judicial branch: Total FTE .....	33,098	33,648	34,129	1,031	3.1%
<b>Grand total</b> .....	<b>4,065,937</b>	<b>4,068,314</b>	<b>4,062,333</b>	<b>-3,604</b>	<b>-0.1%</b>

<sup>1</sup> Includes Postal Rate Commission.<sup>2</sup> Military personnel on active duty. Excludes reserve components.<sup>3</sup> FTE data not available for the Senate (positions filled were used).

TABLE 24-4. PERSONNEL COMPENSATION AND BENEFITS

(In millions of dollars)

Description	2006 Actual	2007 Estimate	2008 Request	Change: 2006 to 2008	
				Dollars	Percent
Civilian personnel costs:					
Executive Branch (excluding Postal Service):					
Direct compensation:					
DOD-military functions .....	42,793	43,412	45,011	2,218	5.2%
All other executive branch .....	87,130	90,409	96,053	8,923	10.2%
Subtotal, direct compensation .....	129,923	133,821	141,064	11,141	8.6%
Personnel benefits:					
DOD-military functions .....	11,638	11,814	12,353	715	6.1%
All other executive branch .....	35,958	36,981	38,428	2,470	6.9%
Subtotal, personnel benefits .....	47,596	48,795	50,781	3,185	6.7%
Subtotal, Executive Branch .....	177,519	182,616	191,845	14,326	8.1%
Postal Service:					
Direct compensation .....	40,578	41,295	41,476	898	2.2%
Personnel benefits .....	13,989	14,005	14,395	406	2.9%
Subtotal .....	54,567	55,300	55,871	1,304	2.4%
Legislative Branch: <sup>1</sup>					
Direct compensation .....	1,842	1,867	2,009	167	9.1%
Personnel benefits .....	504	525	573	69	13.7%
Subtotal .....	2,346	2,392	2,582	236	10.1%
Judicial Branch:					
Direct compensation .....	2,649	2,860	2,985	336	12.7%
Personnel benefits .....	782	859	926	144	18.4%
Subtotal .....	3,431	3,719	3,911	480	14.0%
Total, civilian personnel costs .....	237,863	244,027	254,209	16,346	6.9%
Military personnel costs:					
DOD—Military Functions:					
Direct compensation .....	78,325	85,222	88,774	10,449	13.3%
Personnel benefits .....	42,615	40,114	41,673	-942	-2.2%
Subtotal .....	120,940	125,336	130,447	9,507	7.9%
All other executive branch, uniformed personnel:					
Direct compensation .....	2,579	2,709	2,957	378	14.7%
Personnel benefits .....	987	1,029	1,063	76	7.7%
Subtotal .....	3,566	3,738	4,020	454	12.7%
Total, military personnel costs <sup>2</sup> .....	124,506	129,074	134,467	9,961	8.0%
<b>Grand total, personnel costs .....</b>	<b>362,369</b>	<b>373,101</b>	<b>388,676</b>	<b>26,307</b>	<b>7.3%</b>
<b>ADDENDUM</b>					
Former Civilian Personnel:					
Retired pay for former personnel .....	59,237	62,895	65,593	6,356	10.7%
Government payment for Annuitants:					
Employee health benefits .....	8,360	8,615	9,138	778	9.3%
Employee life insurance .....	41	41	41	.....	.....
Former Military personnel:					
Retired pay for former personnel .....	41,233	43,831	45,846	4,613	11.2%
Military annuitants health benefits .....	7,076	7,680	8,286	1,210	17.1%

<sup>1</sup> Excludes members and officers of the Senate.<sup>2</sup> Excludes reserve components not on active duty.



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## CURRENT SERVICES ESTIMATES

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## 25. CURRENT SERVICES ESTIMATES

Current services estimates or the “baseline” are designed to provide 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. Shortly after enactment of the Budget Enforcement Act (BEA) which provided detailed rules for calculating a baseline, there was a consensus to define the current services estimates according to those rules. 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. Table 25–1

**Table 25–1. BASELINE CATEGORY TOTALS**

(In billions of dollars)

	2006	2007	2008	2009	2010	2011	2012
Receipts .....	2,407	2,550	2,714	2,831	3,008	3,151	3,348
Outlays:							
Discretionary:							
DoD-Military .....	499	511	444	455	464	475	486
Homeland security .....	31	35	36	38	36	37	38
International affairs .....	36	36	34	34	33	33	33
Other discretionary .....	451	450	448	450	454	463	470
Subtotal, discretionary .....	1,017	1,032	961	976	987	1,008	1,028
Mandatory:							
Social Security .....	544	582	608	640	678	718	762
Medicare .....	325	367	391	418	447	493	503
Medicaid and SCHIP .....	186	197	209	224	241	259	279
Other mandatory .....	357	318	330	348	361	381	374
Subtotal, mandatory .....	1,412	1,465	1,537	1,631	1,727	1,850	1,918
Net interest .....	227	238	254	258	259	258	255
Total outlays .....	2,655	2,735	2,752	2,866	2,973	3,116	3,201
Unified deficit .....	-248	-185	-38	-35	34	35	147
On-budget .....	-434	-368	-250	-261	-210	-228	-130
Off-budget .....	186	183	212	225	244	263	277
Memorandum:							
BEA baseline deficit .....	-248	-186	-81	-104	-34	95	287
Do not extend emergencies .....			40	64	72	76	79
Correct growth rates for pay .....			2	3	3	3	3
Remove special rule for administrative expenses of selected programs .....			*	*	1	1	1
Extend certain tax provisions .....		*	-1	-2	-14	-146	-225
Related debt service .....		*	1	4	7	7	2
Current baseline deficit .....	-248	-185	-38	-35	34	35	147

shows current services estimates of receipts, outlays, and surpluses for 2006 through 2012. 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. Table 25–2 shows the changes proposed in the budget relative to the current services estimates. Detailed descriptions of the budget proposals can be found in the main *Budget* volume.

### 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 authoriza-

tion), 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.

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 2007 through 2012, the only taxes affected by this exception are taxes deposited in the Airport and Airway trust fund, which expire on September 30, 2007, and taxes deposited in the Highway trust fund, the Leaking Underground Storage Tank trust fund, and the Sport Fish Restoration and Boating Safety trust fund, which expire on September 30, 2011.
- Direct spending programs that will expire under current law are assumed to be extended if their 2007 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 through the projection period. However, programs enacted after the enactment of the Balanced Budget Act of 1997 that are explicitly temporary in nature expire in the baseline even if

**Table 25–2. IMPACT OF BUDGET POLICY**

(in billions of dollars)

	2007	2008	2009	2010	2011	2012	Total
							2008–2012
Current Services Baseline Deficit .....	-185	-38	-35	34	35	147	143
Proposals:							
Global war on terror and other emergencies .....	-37	-133	-94	-47	-25	-18	-316
Discretionary policy:							
Security .....	-6	-17	-47	-55	-61	-52	-233
Non-security .....	-7	-8	6	15	28	37	79
Subtotal, discretionary .....	-12	-26	-41	-40	-32	-15	-154
Revenue proposals <sup>1</sup> .....	-10	-53	-36	-63	-60	-55	-267
Mandatory proposals:							
Social security personal accounts .....						-30	-30
Other proposals .....	*	10	19	21	28	32	110
2008 Budget Deficit .....	-244	-239	-187	-94	-54	61	-514

\*\$500 million or less.

Note: Each line includes debt service.

<sup>1</sup> Includes outlay impact of revenue proposals.



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 2007, the current services estimates for discretionary programs are equal to enacted 2007 appropriations for accounts included in the Defense and Homeland Security Appropriations Acts. For all other discretionary accounts, current services estimates are set at the annualized continuing resolution rate. For 2008 through 2012, funding for most accounts is equal to this 2007 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 2007, which primarily provide funding for the Global War on Terror, are one-time only expenditures. 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, policy-makers 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 laws 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 2008 through 2012 would be \$314 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 \$110 billion higher over the period 2008 through 2012. If certain provisions of the 2001 and 2003 Tax Acts were assumed to expire, the deficit would be \$404 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 \$18 billion lower in 2008 and \$381 billion lower over the period 2008 through 2012.
- *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 treat-

ment 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 2008 would be reduced by \$553 billion relative to the current estimates. Clearly this would provide an unrealistic estimate of future spending and the government’s future fiscal position.

Table 25–3 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 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 25–4. The economic outlook underlying these as-

**Table 25–3. ALTERNATIVE BASELINE ASSUMPTIONS**

(in billions of dollars)

	2007	2008	2009	2010	2011	2012	2008–2012
Current baseline surplus/deficit .....	-185	-38	-35	34	35	147	143
Alternative assumptions (“+” represents deficit increase):							
Extend provisions affecting parts of mandatory programs <sup>1</sup> .....	-*	-1	-2	-2	-2	-2	-9
Do not extend any authorizing laws:							
Mandatory spending .....		41	51	55	80	87	314
Trust fund excise taxes .....		-12	-13	-14	-16	-55	-110
Certain provisions of the 2001 and 2003 Tax Acts .....	-*	1	2	14	150	237	404
Straightline appropriations .....		18	44	74	106	140	381
Do not extend any appropriations .....		553	863	1,005	1,105	1,193	4,718

<sup>1</sup> 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.

**Table 25–4. SUMMARY OF ECONOMIC ASSUMPTIONS**

(Fiscal years; dollar amounts in billions)

	2007	2008	2009	2010	2011	2012
Gross Domestic Product (GDP):						
Levels, dollar amounts in billions:						
Current dollars .....	13,761	14,515	15,306	16,112	16,938	17,786
Real, chained (2000) dollars .....	11,637	11,985	12,357	12,732	13,114	13,502
Percent change, year over year:						
Current dollars .....	5.4	5.5	5.5	5.3	5.1	5.0
Real, chained (2000) dollars .....	2.8	3.0	3.1	3.0	3.0	3.0
Inflation measures (percent change, year over year):						
GDP chained price index .....	2.5	2.4	2.3	2.2	2.1	2.0
Consumer price index (all urban) .....	2.0	2.6	2.6	2.5	2.4	2.3
Unemployment rate, civilian (percent) .....	4.6	4.7	4.8	4.8	4.8	4.8
Interest rates (percent):						
91-day Treasury bills .....	4.8	4.6	4.4	4.3	4.1	4.1
10-year Treasury notes .....	4.9	5.0	5.2	5.3	5.3	5.3
<b>MEMORANDUM</b>						
Related program assumptions:						
Automatic benefit increases (percent):						
Social security and veterans pensions .....	3.3	1.4	2.6	2.5	2.4	2.3
Federal employee retirement .....	3.3	1.4	2.6	2.5	2.4	2.3
Food stamps .....	2.2	4.1	2.6	2.6	2.4	2.4
Insured unemployment rate .....	1.9	1.9	1.9	2.0	2.0	2.0

sumptions is discussed in greater detail in Chapter 12 of this volume.

### 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 25–5. Assumptions about various automatic cost-of-living-adjustments are shown in Table 25–4.

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 Tax Relief and Health Care Act of 2006, Medicaid Transitional Medical Assistance will expire at the end of June 2007. The baseline does not assume additional spending under this authority beyond that point. Table 25–6 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 25–6 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 25–5. BENEFICIARY PROJECTIONS FOR MAJOR BENEFIT PROGRAMS**

(Annual average, in thousands)

	2006 Actual	Estimate					
		2007	2008	2009	2010	2011	2012
Farmer direct payments .....	1,587	1,579	1,571	1,563	1,555	1,548	1,540
Federal family education loans .....	5,883	6,173	6,396	6,640	6,909	7,191	7,487
Federal direct student loans .....	1,714	1,709	1,767	1,832	1,904	1,978	2,057
Medicaid/State Children's Health Insurance Program .....	52,273	53,353	53,859	54,400	54,914	55,227	55,622
Medicare-eligible military retiree health benefits .....	1,871	1,903	1,938	1,969	1,995	2,025	2,069
Medicare:							
Hospital insurance .....	42,684	43,356	44,190	45,132	46,084	47,153	48,505
Supplementary medical insurance .....	40,100	40,618	41,335	42,134	42,919	43,749	44,894
Railroad retirement .....	583	573	565	558	552	547	542
Federal civil service retirement .....	2,453	2,471	2,488	2,518	2,541	2,564	2,587
Military retirement .....	2,116	2,142	2,162	2,178	2,188	2,193	2,196
Unemployment compensation .....	7,538	7,537	7,982	8,372	8,456	8,543	8,574
Food stamps .....	26,736	26,335	26,245	26,113	25,860	25,661	25,430
Child nutrition .....	32,748	33,713	34,374	34,942	35,465	35,967	36,416
Foster care and adoption assistance .....	600	616	638	658	680	703	727
Supplemental security income (SSI):							
Aged .....	1,116	1,113	1,112	1,111	1,113	1,118	1,128
Blind/disabled .....	5,762	5,932	6,110	6,255	6,378	6,495	6,604
Subtotal, SSI .....	6,878	7,045	7,222	7,366	7,491	7,613	7,732
Child care and development fund <sup>1</sup> .....	2,300	2,200	2,100	2,100	2,000	2,000	2,000
Social security (OASDI):							
Old age and survivor insurance .....	40,264	40,688	41,263	42,007	42,947	43,964	45,074
Disability insurance .....	8,373	8,729	9,056	9,329	9,550	9,764	9,954
Veterans compensation:							
Veterans .....	2,683	2,782	2,879	2,977	3,072	3,164	3,252
Survivors (non-veterans) .....	330	334	341	347	353	359	366
Subtotal, veterans compensation .....	3,013	3,116	3,220	3,324	3,425	3,523	3,618
Veterans pensions:							
Veterans .....	332	326	320	315	309	304	298
Survivors (non-veterans) .....	203	198	193	188	183	178	174
Subtotal, veterans pensions .....	535	524	513	503	492	482	472

<sup>1</sup> 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 25-6. IMPACT OF REGULATIONS, EXPIRING AUTHORIZATIONS, AND OTHER ASSUMPTIONS IN THE BASELINE**

(In millions of dollars)

	Estimate					
	2007	2008	2009	2010	2011	2012
<b>REGULATIONS</b>						
EPA pesticides tolerance fee .....			-13	-13	-13	-13
Foster care and adoption assistance:						
National Youth in Transition Database .....		6	6	7	6	5
Impact of Total Case Management .....	10	65	68	71	73	75
Medicaid: <sup>1</sup>						
Payment Reform .....	-120	-530	-840	-1,170	-1,210	-1,250
School-based Services Administration Reform .....		-615	-670	-725	-785	-850
Medicaid Graduate Medical Education Reform .....		-140	-290	-440	-450	-460
Medicaid Services Reform .....		-230	-360	-520	-570	-610
Managed Care reform .....						
Clarifying Regulations .....						
Payment Error Rate Measurement .....	5	5	5	6	6	7
Medicare: <sup>1</sup>						
Post-Acute Care Provider Reform, Program Integrity, Upcoding Adjustments and other efficiency and productivity improvements .....		-1,000	-1,572	-2,159	-2,637	-2,867
Old age and survivors insurance (OASI) and disability insurance (DI):						
Reduction of Title II benefits under family maximum in cases of dual entitlement .....	18	19	20	21	23	23
Trial work period .....	3	2	1	1		
Expedited reinstatement of disability benefits .....	NA	NA	NA	NA	NA	NA
Continuing disability review failure to cooperate process .....	-10	-12	-12	-12	-13	-14
State Children's Health Insurance Program: <sup>1</sup>						
Payment Error Rate Measurement .....	7	8	8	9	9	10
Supplemental security income (SSI):						
Title XVI cross-program recovery .....	-15	-15	-15	-20	-20	-20
Student earned income exclusion .....	4	4	5	5	5	5
Expedited reinstatement of disability benefits .....	NA	NA	NA	NA	NA	NA
<b>EXPIRING AUTHORIZATIONS</b>						
Provisions extended in the baseline (effect of extension):						
Spending:						
Child care entitlement to States:						
Child care mandatory .....					1,178	1,178
Child care match .....					1,674	1,674
Child care tribal .....					58	58
Training and technical assistance .....					7	7
Child nutrition:						
Summer food service program .....				347	366	386
State administrative expenses .....				191	200	208
CCC market access, bioenergy and commodity programs:						
Counter-cyclical payment program .....			439	949	898	944
Dairy price support program .....		60	55	47	47	47
Dairy export incentive program .....			3			
Direct payment program .....		1,155	5,249	5,249	5,249	5,249
Marketing assistance loan and loan deficiency payment program .....		735	1,154	566	656	844
Sugar nonrecourse loan program .....			170	129	111	117
Market access program .....		200	200	200	200	200
Export credit guarantee programs .....		70	70	70	70	70
Food for progress .....		154	154	154	154	154
Bill Emerson Humanitarian Trust .....		140	140	140	140	140
Conservation reserve program .....		22	102	228	604	1,002
Farm security and rural investment						
Ground and surface water conservation .....		2	17	26	35	43
Farm and ranch lands protection .....		2	37	65	81	97
Food stamps:						
Benefit costs .....		31,875	32,714	33,389	34,115	34,786
State administrative expenses .....		2,644	2,754	2,865	2,977	3,092
Employment and training .....		321	330	338	346	352
Other program costs .....		59	61	62	64	65
Nutrition assistance for Puerto Rico .....		1,612	1,655	1,698	1,739	1,780
Food donations on Indian reservations .....		80	83	86	88	90
The emergency food assistance program commodities .....		140	140	140	140	140
Other activities under the Food Stamp Act of 1977 .....		28	27	26	26	27
Promoting safe and stable families .....						345
Temporary assistance for needy families (TANF) resources:						
State family assistance grants (SFAG) .....					16,553	16,480
SFAG to territories .....					78	78

**Table 25–6. IMPACT OF REGULATIONS, EXPIRING AUTHORIZATIONS, AND OTHER ASSUMPTIONS IN THE BASELINE—Continued**  
(In millions of dollars)

	Estimate					
	2007	2008	2009	2010	2011	2012
Tribal work program .....					8	8
Health Marriage and Fatherhood .....					150	150
Contingency fund .....					91	96
Welfare research .....					15	15
Trade adjustment assistance—training and income support .....		685	841	918	968	992
Trade adjustment assistance—farmers .....		15	15	15	15	15
Veterans compensation—annual cost of living adjustment .....		348	1,132	2,017	2,933	3,876
Revenues:						
Excise taxes dedicated to trust funds:						
Airport and Airway trust fund taxes .....		11,495	12,185	12,906	13,662	14,453
Aquatic Resources trust fund taxes .....						516
Highway trust fund taxes .....						35,940
LUST taxes .....						212
Certain provisions for the 2001 tax cut and 2003 jobs and growth tax cut (includes outlay impact) .....	188	-690	-1,595	-13,789	-146,193	-224,918
Provisions not extended in the baseline (effect of extension):						
Spending:						
Abstinence education (Children and Families Services) .....	5	25	44	49	50	50
Biobased product testing .....		1	1	1	1	1
Biodiesel fuel education .....		1	1	1	1	1
EPA						
Pesticide maintenance fee .....			-15	-15	-15	-15
Pesticide registration service fee .....			-3	-3	-3	-3
Farm bill programs:						
Klamath Basin .....			2	3	6	7
Grassland reserve program .....		14	38	44	46	48
Milk income loss contract program .....		300	185	120	85	70
Small watershed rehabilitation program .....		38	56	65	65	65
Wetlands reserve program .....			18	200	291	364
Wildlife habitat incentives .....		1	18	31	45	58
Medicare, SMI—medicare low income premium assistance .....		425	440	465	495	525
Medicaid—Transitional Medical Assistance .....	35	554	580	601	625	650
Promoting safe and stable families—court improvement grants .....					20	20
TANF—supplemental grants .....			229	287	302	319
Trade adjustment assistance—alternative TAA .....			6	18	24	25
Veterans programs:						
Income verification match .....			4	-1	-5	11
Medicaid for veterans and spouses in nursing homes .....						-576
Adjustable rate mortgages .....			3		3	
Increase loan fees for housing loans .....						-170
Benefits for on-the-job training or apprenticeships .....		10	14	15	15	16
<b>OTHER IMPORTANT PROGRAM ASSUMPTIONS</b>						
Child support enforcement (CSE):						
Alternative penalties for Family Support Act systems and Statewide Disbursement Unit requirements .....	-7	-7	-7	-7		
Federal family education loan program:						
Eliminate voluntary flexible agreements with guarantee agencies .....	-945	-123	-123	-123	-123	-123
Food stamps:						
Tax offset, recoupment, and general claims collection .....	-181	-189	-194	-198	-203	-207
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 .....	59,503	58,634	58,402	57,875	56,708	55,804
Contracting Reform .....		-70	-280	-550	-580	
Medicaid:						
Financial management recoveries .....	-656	-704	-759	-819	-884	-954
Vaccines for Children, total program costs .....	2,905	2,762	2,751	2,704	2,683	2,675
Institutional long term care .....	34,213	36,302	38,262	40,325	42,506	44,808
Home and community based institutional alternatives .....	23,548	25,635	28,836	32,435	36,438	40,983
Pharmaceuticals (FFS, net of rebates) .....	9,766	10,533	11,126	12,026	12,966	13,951
Managed care (including Medicaid MCOs, PHPs, PCCM) .....	35,375	40,223	43,738	47,352	51,486	56,030
State Children's Health Insurance Program (Title XXI) .....	5,647	5,424	5,401	5,497	5,456	5,507
Approved Demonstrations and Pilot Programs: <sup>2</sup>						
Medicare, HI:						
Rural Hospice						
Baseline estimate .....	3	3	3	4		
Demonstration estimate .....	3	3	3	4		

**Table 25–6. IMPACT OF REGULATIONS, EXPIRING AUTHORIZATIONS, AND OTHER ASSUMPTIONS IN THE BASELINE—Continued**  
(In millions of dollars)

	Estimate					
	2007	2008	2009	2010	2011	2012
Mercy Medical						
Baseline estimate .....	6	2				
Demonstration estimate .....	6	2				
Premier						
Baseline estimate .....	2,894	3,047	3,264			
Demonstration estimate .....	2,906	3,059	3,276	12		
Rural Community Hospital <sup>3</sup>						
Baseline estimate .....	48	51	53	33		
Demonstration estimate .....	58	61	64	40		
New York Graduate Medical Education						
Baseline estimate .....	69	69	69			
Demonstration estimate .....	48	35	17			
Utah Graduate Medical Education						
Baseline estimate .....	8					
Demonstration estimate .....	8					
Medicare, SMI:						
Chronic Care Improvement Program (Medicare Health Support)						
Baseline estimate .....						
Demonstration estimate .....	198	177	8			
Expansion of Coverage for Chiropractic Services						
Baseline estimate .....	10					
Demonstration estimate .....	14					
Municipal Health Services Programs						
Baseline estimate .....	4					
Demonstration estimate .....	12	3				
Telemedicine						
Baseline estimate .....	4					
Demonstration estimate .....	4					
United Mine Workers of America Prescription Drugs						
Baseline estimate .....						
Demonstration estimate .....	89					
Coordinated Care Disease Management						
Baseline estimate .....	178	90				
Demonstration estimate .....	158	79				
Lifemasters Disease Management Dual Eligibles						
Baseline estimate .....	655	159				
Demonstration estimate .....	614	149				
Medicare Lifestyle Modification Program						
Baseline estimate .....						
Demonstration estimate .....						
Care Management for High-Cost Beneficiaries						
Baseline estimate .....						
Demonstration estimate .....	95	82	13			
Low Vision Rehabilitation						
Baseline estimate .....	8	8	8	8		
Demonstration estimate .....	10	10	10	10		
Cancer Prevention and Treatment for Ethnic and Racial Minorities						
Baseline estimate .....	5	5	6	7		
Demonstration estimate .....	5	5	6	7		
Medical Adult Day Care						
Baseline estimate .....	3	3	3	3		
Demonstration estimate .....	2	2	3	3		
Demo to Limit Annual Change in Part D Premiums						
Baseline estimate .....						
Demonstration estimate .....	640	210	60			
Demo to Transition Enrollment of “Low-Income Subsidy Beneficiaries”						
Baseline estimate .....						
Demonstration estimate .....	360	220	240	140	30	
Part D Reconciliation to States (402 demos)						
Baseline estimate .....						
Demonstration estimate .....	178					
Part D Payment (reinsurance)						
Baseline estimate .....						
Demonstration estimate .....						
Part D Late Enrollment Penalty Waiver <sup>4</sup>						
Baseline estimate .....						
Demonstration estimate .....						

**Table 25–6. IMPACT OF REGULATIONS, EXPIRING AUTHORIZATIONS, AND OTHER ASSUMPTIONS IN THE BASELINE—Continued**  
(In millions of dollars)

	Estimate					
	2007	2008	2009	2010	2011	2012
Medicare: HI and SMI:						
ESRD Disease Management						
Baseline estimate .....	192	199	205	53		
Demonstration estimate .....	191	198	204	53		
Home Health Third Party Liability						
Baseline estimate .....	191	174	187	158	13	
Demonstration estimate .....	186	171	182	153	13	
Medicare+Choice Phase I						
Baseline estimate .....						
Demonstration estimate .....	6					
Medicare+Choice Phase II						
Baseline estimate .....						
Demonstration estimate .....	66					
S/HMO I						
Baseline estimate .....	1,731	558				
Demonstration estimate .....	1,990	664				
S/HMO II						
Baseline estimate .....	619	198				
Demonstration estimate .....	711	228				
Physician Group Practice						
Baseline estimate .....	1,793	463				
Demonstration estimate .....	1,667	468	77			
Medical Savings Account						
Baseline estimate .....	1	2	4	6	8	
Demonstration estimate .....						
United Mine Workers of America Health						
Baseline estimate .....	520					
Demonstration estimate .....	502	6				
Medicaid (baseline estimates): <sup>5</sup>						
Alabama Family Planning .....	214	238				
Arizona AHCCCS .....	4,365	4,839	5,356	5,932	6,571	
Arkansas (ARKids B) .....	91	102				
Arkansas Family Planning Services .....	229	249				
Arkansas Independent Choices (Cash & Counseling) <sup>6</sup> .....	5					
Arkansas TEFRA .....	32	8				
California Family Planning .....	612					
California In-Home Supportive Services Plus <sup>6</sup> .....	325	378	357			
California—MediCal Hospital/Uninsured Care .....	766	766	766	702		
Colorado Consumer Directed Attendant Support <sup>6</sup> .....	19	3				
Delaware—Diamond State Health Plan .....	335	286	302	76		
District of Columbia Childless Adults 50–64 .....	3					
District of Columbia HIV .....	11	14	18	6		
Florida Consumer Directed Care Plus (Cash & Counseling) <sup>6</sup> .....	61	26				
Florida Family Planning .....	910	967	1,068			
Florida MEDS-AD Program .....	975	1,072	1,180	1,298		
Florida medicaid reform .....	4,875	5,662	6,589	7,683	4,137	
Hawaii Health QUEST .....	256	289	237			
Illinois Family Planning .....	414	443				
IowaCare .....	109	117	125	134		
Iowa Family Planning .....	175	189	205			
Kentucky Health Care Partnership Program .....	513	568	48			
Louisiana Family Planning .....	445	483	525	569		
Maine HIV .....	7					
Maryland (Health Choice) .....	1,610	1,086				
Massachusetts MassHealth .....	2,757	2,960				
Michigan Family Planning .....	425	462	503	547		
Minnesota (Prepaid Med. Assist. Project Plus) .....	186	148				
Minnesota Family Planning .....	248					
Mississippi Family Planning .....	146					
Mississippi—Healthier Mississippi .....	71	78	86			
Missouri Managed Care Plus .....	86					
Montana Basic Medicaid for Able-Bodied Adults .....	35	39	13			
New Jersey Personal Preference (Cash & Counseling) <sup>6</sup> .....	5	3				
New Mexico—Family Planning .....	109	114	119			
New York (Partnership Plan) .....	7,142	7,823	7,685			
New York Federal-State Health Reform Partnership .....	10,248	10,907	11,609	12,357	13,153	
North Carolina Family Planning .....	424	457	494			

**Table 25–6. IMPACT OF REGULATIONS, EXPIRING AUTHORIZATIONS, AND OTHER ASSUMPTIONS IN THE BASELINE—Continued**  
(In millions of dollars)

	Estimate					
	2007	2008	2009	2010	2011	2012
Oklahoma Family Planning .....	159	166				
Oregon Family Planning .....	156	169	183			
Oregon Independent Choices <sup>6</sup> .....	2					
Rhode Island Rite Care (Medicaid) .....	192	169				
South Carolina Family Planning .....	54	57				
TennCare II .....	3,124					
Utah (Primary Care Network) .....	106	110	117			
Vermont Long Term Care Plan <sup>7</sup> .....	121	135	149	166		
Vermont Global Commitment to Health .....	494	538	586	639	160	
Virginia—Family Planning .....	176					
Washington (Take Charge/Family Planning) .....	296	312	329			
Wisconsin Badger Care (Medicaid) .....	18					
Wisconsin Family Planning .....	23					
Pharmacy plus (demonstration estimate)						
Wisconsin Pharmacy Plus .....	100					
State Children's Health Insurance Program (Title XXI) (demonstration estimates): <sup>5</sup>						
Alaska .....	9	10	11			
Hawaii .....	1	8	9			
Maryland Health Choice <sup>8</sup> .....	150					
Minnesota Care:						
Demonstration estimate (SCHIP funds) .....	39	41	39			
Baseline estimate (medicaid funds) .....						
Missouri MC+c <sup>8</sup> .....	56					
New Jersey Family Care <sup>9</sup> .....	167	173				
New Mexico SCHIP <sup>8</sup> .....	26					
Rhode Island (SCHIP RiteCare) <sup>9</sup> .....	34	11				
Wisconsin (BadgerCare) .....	88					
Health Insurance Flexibility and Accountability (HIFA) (demonstration estimate—SCHIP funds): <sup>5</sup>						
Arizona HIFA—amendment to AHCCCS .....	36	29	24	26	28	144
Arkansas HIFA						
Demonstration estimate .....	4	8	13	24	31	
Baseline estimate (medicaid funds) .....	1,421	1,604	1,813	2,049	2,318	
Colorado HIFA .....	13	16	18			
Idaho HIFA .....	13	14	11			
Illinois HIFA (KidCare Parent Coverage)						
Demonstration estimate .....	159					
Baseline estimate (medicaid funds) .....	6					
Maine HIFA (Maine Care for Childless Adults)						
Baseline estimate (medicaid funds) .....	102					
Michigan HIFA .....	120	112	24			
Nevada HIFA .....	11	16	19	21	17	
New Mexico HIFA .....	21	24	27			
Oklahoma Sooner Care Demo+HIFA						
Baseline estimate (medicaid funds) .....	998	1,071	1,137	289		
Oregon HIFA (Oregon Health Plan 2)						
Demonstration estimate (SCHIP funds) .....	16					
Baseline estimate (medicaid funds) .....	1,603					
Virginia HIFA .....	12	12	13			
Joint Medicare and Medicaid:						
Minnesota-Dual Eligibles						
Baseline estimate .....	1,213	339				
Demonstration estimate .....	1,213	339				
Wisconsin Health Partnership Dual Eligible						
Baseline estimate .....	125	35				
Demonstration estimate .....	125	35				
Massachusetts SCO Dual Eligible						
Demonstration estimate .....	175	47				
Baseline estimate .....	175	47				
OASI, DI, SSI:						
Performance of continuing disability reviews (baseline levels):						
OASDI .....	-11	-60	-128	-211	-378	-714
SSI (federal) .....	-33	-172	-318	-462	-654	-725
Collection of overpayments:						
OASI .....	-719	-779	-836	-892	-949	-1,009
DI .....	-691	-769	-843	-915	-984	-1,055
SSI (federal) .....	-928	-986	-1,043	-1,101	-1,155	-1,217



**Table 25–6. IMPACT OF REGULATIONS, EXPIRING AUTHORIZATIONS, AND OTHER ASSUMPTIONS IN THE BASELINE—Continued**  
(In millions of dollars)

	Estimate					
	2007	2008	2009	2010	2011	2012
Debts written off as uncollectable (no effect on outlays):						
OASI .....	134	145	155	166	176	188
DI .....	474	527	578	628	675	723
SSI (federal) .....	415	441	467	492	516	544
OASDI:						
Payments to states for vocational rehabilitation .....	80	88	95	104	112	120
DI:						
Research and demonstration projects .....	50	57	30			
SSI:						
Payments from states for state supplemental benefits .....	-4,050	-4,555	-4,755	-4,960	-5,565	-4,965
Payments for state supplemental benefits .....	4,430	4,572	4,772	4,975	5,137	5,428
Fees for administration of State supplement:						
Treasury share .....	-128	-143	-146	-149	-164	-141
SSA share .....	-119	-122	-125	-127	-130	-133
Research and demonstration projects .....	33	28	27	27	27	27
Payments to states for vocational rehabilitation .....	53	56	59	62	66	71
Performance of non-disability redeterminations (excludes related overpayment collections reported above) .....	602	239	2	-49	-137	-681
Royalties and offshore minerals management:						
Increased deepwater oil and gas leases royalty rates .....		150	60	50	30	10
Royalty-in-kind oil to fill Strategic Petroleum Reserve .....	435	1,102				
State grants and demonstrations—health care:						
Ticket to work grant programs:						
Infrastructure grant program .....	17	20	20	32	35	37
Demonstration to maintain independence and employment .....	21	22	22	10	10	10
High risk pools:						
Initial seed grants .....	2					
Operation of pools .....	78					
Emergency health services for undocumented aliens .....	200	200	133	200		
Katrina relief .....	1,039					
Psychiatric residential treatment demonstration .....	10	17	28	33	35	
Money Follow the Person demonstration .....	18	57	121	213	320	
Medicaid transformation grants .....	75	75				
Medicaid integrity program .....	55	50	75	75	75	75

\* = \$500,000 or less.

NA = Not available.

<sup>1</sup> Medicare and Medicaid/SCHIP regulations reflect gross outlays.

<sup>2</sup> Baseline estimates reflect costs absent the demonstration; demonstration estimate reflects costs of the demonstration. The differences represent the net impact of the demonstration. Any demonstrations are implicitly assumed in the current services baseline.

<sup>3</sup> Costs of this demonstration are offset annually by a reduction to inpatient hospital prospective payment rates.

<sup>4</sup> Costs of this demonstration are estimated to be negligible over 10 years.

<sup>5</sup> Baseline estimates reflect costs absent the demonstration. Demonstration estimates reflect cost of the demonstration.

<sup>6</sup> Consumer directed program in which "plan of care" is converted to a cash allotment. It is expected that these will convert to DRA State Plan options upon expiration.

<sup>7</sup> Adjustments have been made since prior year submission to account for Part D.

<sup>8</sup> Estimates reflect costs for SCHIP children under the State's Medicaid 1115.

<sup>9</sup> States project covering a portion of their entire demonstration population with Medicaid funds.

### Current Services Receipts, Outlays, and Budget Authority

*Receipts.*—Table 25–7 shows baseline receipts by major source. Total receipts are projected to increase by \$164 billion from 2007 to 2008 and by \$634 billion from 2008 to 2012, largely due to assumed increases in incomes resulting from both real economic growth and inflation.

Individual income taxes are estimated to increase by \$117 billion from 2007 to 2008 under baseline assumptions. This growth of 9.9 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 6.4 percent between 2008 and 2012.

**Table 25–7. BASELINE RECEIPTS BY SOURCE**

(In billions of dollars)

	2006 Actual	Estimate					
		2007	2008	2009	2010	2011	2012
Individual income taxes .....	1,044	1,178	1,295	1,349	1,465	1,547	1,657
Corporation income taxes .....	354	342	319	327	334	350	377
Social insurance and retirement receipts .....	838	873	926	972	1,027	1,084	1,137
On-budget .....	229	239	252	261	274	288	301
Off-budget .....	608	634	674	711	753	796	835
Excise taxes .....	74	58	69	72	73	78	81
Estate and gift taxes .....	28	25	26	27	22	2	1
Other .....	70	73	80	83	87	91	95
Total .....	2,407	2,550	2,714	2,831	3,008	3,151	3,348
On-budget .....	1,799	1,916	2,040	2,119	2,254	2,356	2,513
Off-budget .....	608	634	674	711	753	796	835

Corporation income taxes under current law are estimated to decline by \$23 billion or 6.8 percent between 2007 and 2008, in large part due to economic factors and legislated tax changes. Corporation income taxes are projected to increase at an annual rate of 4.3 percent from 2008 to 2012, reflecting higher corporate profits.

Social insurance and retirement receipts are estimated to increase by \$52 billion between 2007 and 2008, and by an additional \$211 billion between 2008 and 2012. The estimates reflect assumed increases in total wages and salaries paid, and scheduled increases in the social security taxable earnings base from \$97,500 in 2007 to \$123,600 in 2012.

Excise taxes are estimated to be unusually low in 2007 due to refunds of certain telephone excise taxes. They return to normal levels in 2008 and increase by \$13 billion from 2008 to 2012, 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 \$22 billion from 2007 to 2012.

*Outlays.*—Current services outlays are estimated to grow from \$2,735 billion in 2007 to \$2,752 billion in 2008, a 0.6 percent increase. This small increase is in part due to calendar quirks. When October 1 falls on a weekend, military pay and certain benefit payments are paid on the previous Friday, shifting them into the previous fiscal year. Between 2007 and 2012, current services outlays are projected to increase at

an average annual rate of 3.2 percent. October 1 falls on a weekend in both 2007 and 2012.

Even though most discretionary spending is assumed to grow with inflation, outlays for discretionary programs decline from \$1,032 billion in 2007 to \$961 billion in 2008 because the baseline assumes no additional spending for the war beyond what is already enacted. Outlays increase each year thereafter, reflecting increases in resources to keep pace with inflation, reaching \$1,028 billion in 2012. Entitlement and other mandatory programs are estimated to grow from \$1,465 billion in 2007 to \$1,537 billion in 2008, and to \$1,918 billion in 2012, 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 \$582 billion in 2007 to \$762 billion in 2012, an average annual rate of 5.5 percent. Medicare and medicaid are projected to grow at annual average rates of 6.5 and 7.3 percent, respectively, outpacing inflation. Other areas of growth include federal employee retirement (average annual growth of 3.5 percent), unemployment compensation (5.6 percent) and veterans programs (6.6 percent). Net interest payments to the public total \$238 billion in 2007 and \$254 billion in 2008 and remain nearly level through the projection period.

Tables 25–9 and 25–10 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 25–11 and 25–12 show current services estimates of budget authority by function and by agency, respectively. A more detailed presen-

tation of budget authority with program level estimates appears on the CD-ROM that accompanies this volume.

**Table 25–8. CHANGE IN BASELINE OUTLAY ESTIMATES BY CATEGORY**

(Dollar amounts in billions)

	2007	2008	2012	Change 2007 to 2008		Change 2007 to 2012	
				Amount	Percent	Amount	Annual average rate
<b>Outlays:</b>							
<b>Discretionary:</b>							
DoD-Military .....	511	444	486	-67	-13.1%	-25	-1.0%
Homeland security .....	35	36	38	*	0.9%	3	1.5%
International affairs .....	36	34	33	-2	-6.2%	-3	-1.7%
Other discretionary .....	486	482	504	-4	-0.9%	18	0.7%
Subtotal, discretionary .....	1,032	961	1,028	-71	-6.8%	-4	-0.1%
<b>Mandatory:</b>							
Farm programs .....	14	14	15	-1	-3.8%	*	0.3%
Medicaid .....	192	204	273	12	6.3%	82	7.3%
Other health care .....	23	24	30	1	3.0%	7	5.2%
Medicare .....	367	391	503	23	6.3%	136	6.5%
Federal employee retirement and disability .....	105	109	124	4	4.3%	20	3.5%
Unemployment compensation .....	32	34	42	2	7.3%	10	5.6%
Other income security programs .....	174	182	193	8	4.8%	19	2.1%
Social Security .....	582	608	762	26	4.4%	180	5.5%
Veterans programs .....	39	45	53	6	15.9%	15	6.6%
Other mandatory programs .....	20	13	15	-7	-33.8%	-5	-5.7%
Undistributed offsetting receipts .....	-82	-86	-91	-4	5.0%	-10	2.3%
Subtotal, mandatory .....	1,465	1,537	1,918	72	4.9%	453	5.5%
Net interest .....	238	254	255	16	6.7%	17	1.4%
<b>Total outlays .....</b>	<b>2,735</b>	<b>2,752</b>	<b>3,201</b>	<b>17</b>	<b>0.6%</b>	<b>466</b>	<b>3.2%</b>

Table 25-9. CURRENT SERVICES OUTLAYS BY FUNCTION

(in billions of dollars)

Function	2006 Actual	Estimate					
		2007	2008	2009	2010	2011	2012
National defense:							
Department of Defense—Military .....	499.3	512.4	446.1	457.6	466.0	477.2	488.5
Other .....	22.5	22.7	23.2	23.6	23.5	23.4	23.8
Total, National defense .....	521.8	535.1	469.3	481.1	489.5	500.6	512.3
International affairs .....	29.5	32.7	32.0	31.8	30.8	30.7	31.3
General science, space, and technology .....	23.6	24.9	25.7	26.6	26.6	27.1	27.7
Energy .....	0.8	1.8	1.5	1.7	1.9	2.1	2.1
Natural resources and environment .....	33.1	35.1	33.1	31.9	33.1	33.8	34.9
Agriculture .....	26.0	20.1	19.8	19.6	20.1	20.8	21.1
Commerce and housing credit .....	6.2	0.2	-1.4	0.7	-0.4	-0.2	1.0
On-Budget .....	(7.3)	(-2.4)	(0.9)	(-1.0)	(-1.7)	(-2.1)	(0.2)
Off-Budget .....	(-1.1)	(2.6)	(-2.3)	(1.7)	(1.3)	(1.9)	(0.8)
Transportation .....	70.2	74.6	78.2	78.1	79.5	80.8	82.7
Community and regional development .....	54.5	31.4	23.7	20.4	17.4	17.9	14.5
Education, training, employment, and social services .....	118.6	94.0	88.2	91.0	94.2	96.0	97.3
Health .....	252.8	268.5	281.7	300.2	316.4	336.5	359.6
Medicare .....	329.9	372.3	395.6	423.4	452.4	498.1	508.8
Income security .....	352.5	365.4	380.4	389.4	399.5	415.5	415.0
Social security .....	548.5	586.5	612.5	644.9	683.3	723.0	767.4
On-Budget .....	(16.1)	(19.4)	(20.0)	(22.0)	(24.2)	(27.1)	(30.1)
Off-Budget .....	(532.5)	(567.2)	(592.5)	(622.9)	(659.1)	(695.8)	(737.3)
Veterans benefits and services .....	69.8	72.4	79.5	83.3	87.4	95.9	92.0
Administration of justice .....	41.0	45.3	44.7	44.9	45.5	46.2	47.6
General government .....	18.2	18.8	19.8	19.6	20.1	21.0	22.1
Net interest .....	226.6	237.7	253.5	258.4	259.1	257.8	255.0
On-Budget .....	(324.3)	(343.9)	(368.2)	(383.2)	(395.6)	(407.0)	(417.9)
Off-Budget .....	(-97.7)	(-106.2)	(-114.6)	(-124.8)	(-136.5)	(-149.3)	(-162.9)
Allowances .....							
Undistributed offsetting receipts:							
Employer share, employee retirement (on-budget) .....	-49.2	-48.8	-51.7	-55.0	-58.4	-62.1	-65.6
Employer share, employee retirement (off-budget) .....	-11.6	-12.3	-13.1	-13.8	-14.7	-15.8	-16.6
Rents and royalties on the Outer Continental Shelf .....	-7.3	-6.8	-9.1	-9.9	-9.9	-9.6	-9.3
Sale of major assets .....				-0.3			
Other undistributed offsetting receipts .....	-0.1	-13.8	-11.8	-2.2	-0.1	-0.1	
Total, Undistributed offsetting receipts .....	-68.2	-81.7	-85.8	-81.3	-83.1	-87.6	-91.5
On-Budget .....	(-56.6)	(-69.4)	(-72.6)	(-67.4)	(-68.4)	(-71.8)	(-74.9)
Off-Budget .....	(-11.6)	(-12.3)	(-13.1)	(-13.8)	(-14.7)	(-15.8)	(-16.6)
<b>Total .....</b>	<b>2,655.4</b>	<b>2,735.0</b>	<b>2,752.1</b>	<b>2,865.7</b>	<b>2,973.5</b>	<b>3,115.9</b>	<b>3,200.9</b>
On-Budget .....	(2,233.4)	(2,283.7)	(2,289.6)	(2,379.8)	(2,464.3)	(2,583.2)	(2,642.2)
Off-Budget .....	(422.1)	(451.3)	(462.5)	(485.9)	(509.2)	(532.7)	(558.7)

Table 25-10. CURRENT SERVICES OUTLAYS BY AGENCY

(in billions of dollars)

Agency	2006 Actual	Estimate					
		2007	2008	2009	2010	2011	2012
Legislative Branch .....	4.1	4.3	4.3	4.3	4.5	4.7	4.8
Judicial Branch .....	5.8	5.8	6.1	6.3	6.5	6.8	7.0
Agriculture .....	93.5	88.6	89.3	90.6	93.2	96.2	98.9
Commerce .....	6.4	6.2	6.5	6.9	7.0	6.8	6.7
Defense—Military .....	499.4	512.4	446.1	457.6	466.0	477.2	488.5
Education .....	93.4	68.0	62.8	65.1	67.5	68.8	69.5
Energy .....	19.6	21.9	21.8	22.7	22.8	22.7	23.2
Health and Human Services .....	614.3	671.2	705.4	748.6	794.8	860.3	892.7
Homeland Security .....	69.1	49.1	40.4	38.8	34.6	35.0	35.9
Housing and Urban Development .....	42.4	42.8	44.2	43.5	42.5	43.5	40.5
Interior .....	9.1	10.9	10.6	10.4	11.0	11.1	11.4
Justice .....	23.3	22.9	23.9	24.8	25.2	25.3	26.1
Labor .....	43.1	47.4	50.4	51.6	54.0	56.3	58.0
State .....	13.0	15.3	14.5	14.6	14.3	14.2	14.5
Transportation .....	60.1	63.8	66.1	65.4	66.3	67.2	68.6
Treasury .....	464.7	489.0	519.5	539.5	557.7	575.1	588.7
Veterans Affairs .....	69.8	72.3	79.4	83.2	87.3	95.6	91.8
Corps of Engineers—Civil Works .....	6.9	7.4	6.4	5.2	5.3	5.4	5.5
Other Defense Civil Programs .....	44.4	47.6	49.1	50.4	51.4	52.5	52.8
Environmental Protection Agency .....	8.3	8.0	7.9	8.2	8.4	8.5	8.7
Executive Office of the President .....	5.4	2.7	1.4	0.7	0.5	0.4	0.4
General Services Administration .....	*	0.5	0.6	-0.2	-0.3	-0.4	-0.3
International Assistance Programs .....	13.9	16.5	16.3	16.6	16.3	16.3	16.6
National Aeronautics and Space Administration .....	15.1	16.1	16.8	17.6	17.5	17.7	18.2
National Science Foundation .....	5.5	5.9	5.8	5.9	6.0	6.2	6.3
Office of Personnel Management .....	62.4	58.8	64.2	66.8	69.2	71.2	73.9
Small Business Administration .....	0.9	0.7	0.7	0.5	0.5	0.5	0.5
Social Security Administration .....	585.7	622.9	654.4	689.0	729.7	775.8	813.7
On-Budget .....	(53.3)	(55.7)	(61.9)	(66.1)	(70.6)	(80.0)	(76.4)
Off-Budget .....	(532.5)	(567.2)	(592.5)	(622.9)	(659.1)	(695.8)	(737.3)
Other Independent Agencies .....	12.9	18.7	15.3	17.6	17.3	18.3	20.1
On-Budget .....	(14.0)	(16.0)	(17.6)	(15.9)	(16.0)	(16.4)	(19.2)
Off-Budget .....	(-1.1)	(2.6)	(-2.3)	(1.7)	(1.3)	(1.9)	(0.8)
Allowances .....	-----	-----	-----	-----	-----	-----	-----
Undistributed Offsetting Receipts .....	-237.5	-263.0	-278.1	-286.5	-303.4	-323.3	-342.3
On-Budget .....	(-128.2)	(-144.5)	(-150.4)	(-147.9)	(-152.2)	(-158.2)	(-162.8)
Off-Budget .....	(-109.3)	(-118.5)	(-127.7)	(-138.6)	(-151.2)	(-165.1)	(-179.5)
<b>Total .....</b>	<b>2,655.4</b>	<b>2,735.0</b>	<b>2,752.1</b>	<b>2,865.7</b>	<b>2,973.5</b>	<b>3,115.9</b>	<b>3,200.9</b>
On-Budget .....	(2,233.4)	(2,283.7)	(2,289.6)	(2,379.8)	(2,464.3)	(2,583.2)	(2,642.2)
Off-Budget .....	(422.1)	(451.3)	(462.5)	(485.9)	(509.2)	(532.7)	(558.7)

\* \$50 million or less.

Table 25–11. CURRENT SERVICES BUDGET AUTHORITY BY FUNCTION

(in billions of dollars)

Function	2006 Actual	Estimate					
		2007	2008	2009	2010	2011	2012
National defense:							
Department of Defense—Military .....	593.8	501.2	443.9	457.3	470.6	484.2	497.8
Other .....	23.4	21.8	22.5	22.8	23.1	23.6	24.0
Total, National defense .....	617.2	523.0	466.4	480.0	493.8	507.7	521.8
International affairs .....	32.8	27.1	29.5	31.1	31.9	32.7	33.6
General science, space, and technology .....	25.1	24.9	25.5	26.2	26.8	27.4	28.0
Energy .....	0.3	1.2	1.5	1.6	1.8	2.1	2.2
Natural resources and environment .....	38.1	29.7	31.0	31.3	32.7	33.7	34.9
Agriculture .....	25.6	19.1	20.0	19.7	20.5	20.9	21.5
Commerce and housing credit .....	14.3	11.1	10.4	8.4	8.2	8.8	8.0
On-Budget .....	(10.6)	(2.8)	(6.7)	(6.7)	(6.9)	(6.9)	(7.2)
Off-Budget .....	(3.7)	(8.3)	(3.7)	(1.7)	(1.3)	(1.9)	(0.8)
Transportation .....	75.7	77.7	83.4	84.3	85.1	86.0	86.9
Community and regional development .....	31.2	12.7	13.0	13.5	13.8	14.2	14.6
Education, training, employment, and social services .....	125.9	91.7	92.2	94.8	97.6	98.6	100.8
Health .....	295.2	242.3	283.5	303.1	320.5	341.9	364.7
Medicare .....	365.4	371.9	395.5	423.8	452.1	498.1	509.2
Income security .....	351.1	361.0	377.9	390.3	402.3	421.1	419.0
Social security .....	552.2	589.2	614.6	647.9	686.6	726.3	771.3
On-Budget .....	(16.1)	(19.4)	(20.0)	(22.0)	(24.2)	(27.1)	(30.1)
Off-Budget .....	(536.2)	(569.9)	(594.6)	(625.9)	(662.4)	(699.1)	(741.2)
Veterans benefits and services .....	71.0	74.5	79.5	83.8	88.0	92.4	96.8
Administration of justice .....	42.7	43.7	44.7	43.9	45.1	46.6	48.0
General government .....	19.7	18.6	19.0	19.8	20.4	21.2	22.1
Net interest .....	226.6	237.7	253.5	258.4	259.1	257.8	255.0
On-Budget .....	(324.3)	(343.9)	(368.2)	(383.2)	(395.6)	(407.0)	(417.9)
Off-Budget .....	(-97.7)	(-106.2)	(-114.6)	(-124.8)	(-136.5)	(-149.3)	(-162.9)
Allowances .....							
Undistributed offsetting receipts:							
Employer share, employee retirement (on-budget) .....	-49.2	-48.8	-51.7	-55.0	-58.4	-62.1	-65.6
Employer share, employee retirement (off-budget) .....	-11.6	-12.3	-13.1	-13.8	-14.7	-15.8	-16.6
Rents and royalties on the Outer Continental Shelf .....	-7.3	-6.8	-9.1	-9.9	-9.9	-9.6	-9.3
Sale of major assets .....				-0.3			
Other undistributed offsetting receipts .....	-0.1	-13.8	-11.8	-2.2	-0.1	-0.1	
Total, Undistributed offsetting receipts .....	-68.2	-81.7	-85.8	-81.3	-83.1	-87.6	-91.5
On-Budget .....	(-56.6)	(-69.4)	(-72.6)	(-67.4)	(-68.4)	(-71.8)	(-74.9)
Off-Budget .....	(-11.6)	(-12.3)	(-13.1)	(-13.8)	(-14.7)	(-15.8)	(-16.6)
<b>Total</b> .....	<b>2,841.7</b>	<b>2,675.4</b>	<b>2,755.7</b>	<b>2,880.6</b>	<b>3,003.4</b>	<b>3,149.8</b>	<b>3,246.7</b>
On-Budget .....	(2,411.1)	(2,215.8)	(2,285.1)	(2,391.7)	(2,490.9)	(2,613.8)	(2,684.1)
Off-Budget .....	(430.5)	(459.6)	(470.6)	(488.9)	(512.5)	(536.0)	(562.6)
<b>MEMORANDUM</b>							
Discretionary budget authority:							
National defense .....	556.5	519.9	462.9	476.6	490.4	504.3	518.3
International .....	35.9	29.9	30.7	31.4	32.2	33.0	33.7
Domestic .....	404.3	375.4	393.6	404.5	415.4	426.5	437.9
<b>Total</b> .....	<b>996.7</b>	<b>925.2</b>	<b>887.2</b>	<b>912.6</b>	<b>938.0</b>	<b>963.8</b>	<b>990.0</b>

Table 25-12. CURRENT SERVICES BUDGET AUTHORITY BY AGENCY

(in billions of dollars)

Agency	2006 Actual	Estimate					
		2007	2008	2009	2010	2011	2012
Legislative Branch .....	4.2	4.2	4.3	4.5	4.6	4.8	5.0
Judicial Branch .....	6.0	5.9	6.1	6.3	6.6	6.8	7.0
Agriculture .....	97.3	87.4	91.8	93.1	96.1	99.1	102.0
Commerce .....	6.6	7.9	6.1	6.4	6.5	6.7	6.9
Defense—Military .....	593.8	501.2	443.9	457.3	470.6	484.2	497.8
Education .....	100.1	66.3	66.3	68.3	70.5	71.0	72.6
Energy .....	21.1	20.5	21.2	21.7	22.2	22.8	23.3
Health and Human Services .....	684.6	643.3	706.8	751.1	798.3	866.7	897.4
Homeland Security .....	32.4	34.1	33.1	35.5	34.3	35.3	36.3
Housing and Urban Development .....	52.4	33.8	38.4	39.3	40.3	41.0	41.8
Interior .....	10.0	9.7	10.1	10.4	11.0	11.2	11.5
Justice .....	23.1	22.6	24.6	24.1	24.7	25.5	26.4
Labor .....	45.9	46.7	49.5	51.4	53.7	55.7	57.6
State .....	15.4	13.0	13.3	13.6	14.0	14.3	14.7
Transportation .....	64.4	65.6	71.0	71.4	71.8	72.2	72.6
Treasury .....	466.6	490.5	520.4	540.3	558.8	576.2	589.6
Veterans Affairs .....	71.0	74.4	79.5	83.7	87.9	92.1	96.6
Corps of Engineers—Civil Works .....	11.9	4.7	4.8	5.0	5.2	5.4	5.6
Other Defense Civil Programs .....	44.7	47.8	49.2	50.6	51.6	52.7	53.0
Environmental Protection Agency .....	7.6	7.5	7.7	7.9	8.1	8.4	8.6
Executive Office of the President .....	0.3	0.4	0.3	0.4	0.4	0.4	0.4
General Services Administration .....	0.7	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2
International Assistance Programs .....	18.7	14.5	15.1	16.4	16.8	17.2	17.6
National Aeronautics and Space Administration .....	16.6	16.2	16.6	17.0	17.5	17.9	18.3
National Science Foundation .....	5.7	5.7	5.9	6.0	6.2	6.3	6.4
Office of Personnel Management .....	66.8	62.2	66.9	69.5	72.0	75.5	77.0
Small Business Administration .....	1.8	0.4	0.5	0.5	0.5	0.5	0.5
Social Security Administration .....	589.5	626.3	655.5	692.0	733.0	778.7	818.1
On-Budget .....	(53.4)	(56.4)	(60.9)	(66.2)	(70.6)	(79.6)	(76.9)
Off-Budget .....	(536.2)	(569.9)	(594.6)	(625.9)	(662.4)	(699.1)	(741.2)
Other Independent Agencies .....	20.0	26.0	25.0	23.5	23.8	24.9	24.5
On-Budget .....	(16.3)	(17.7)	(21.3)	(21.8)	(22.4)	(23.0)	(23.7)
Off-Budget .....	(3.7)	(8.3)	(3.7)	(1.7)	(1.3)	(1.9)	(0.8)
Allowances .....	-----	-----	-----	-----	-----	-----	-----
Undistributed Offsetting Receipts .....	-237.5	-263.0	-278.1	-286.5	-303.4	-323.3	-342.3
On-Budget .....	(-128.2)	(-144.5)	(-150.4)	(-147.9)	(-152.2)	(-158.2)	(-162.8)
Off-Budget .....	(-109.3)	(-118.5)	(-127.7)	(-138.6)	(-151.2)	(-165.1)	(-179.5)
<b>Total .....</b>	<b>2,841.7</b>	<b>2,675.4</b>	<b>2,755.7</b>	<b>2,880.6</b>	<b>3,003.4</b>	<b>3,149.8</b>	<b>3,246.7</b>
On-Budget .....	(2,411.1)	(2,215.8)	(2,285.1)	(2,391.7)	(2,490.9)	(2,613.8)	(2,684.1)
Off-Budget .....	(430.5)	(459.6)	(470.6)	(488.9)	(512.5)	(536.0)	(562.6)





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## THE BUDGET SYSTEM AND CONCEPTS

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## 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 doc-

uments 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 2008. (Fiscal year 2008 will begin on October 1, 2007 and end on September 30, 2008.) 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 2007, 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 2006, 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 Congress eight months to act on the budget before the fiscal year begins.

### **Congressional Action<sup>1</sup>**

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 for Federal 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 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

<sup>1</sup>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).

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 budgetary resources 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.

For 23 of the last 26 fiscal years, including 2007, 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.

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. 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 regular appropriations acts are 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.

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 only control about 35 percent of the total spending in a typical year. Authorizing legislation controls 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 authorizing 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 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 permissible 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 authorizing 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 in-

crease 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 of this volume, "Budget Reform Proposals."

### 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 six years ago.

### 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)

	2006 actual	Estimate	
		2007	2008
<b>Budget authority:</b>			
Unified .....	2,842	2,799	2,941
On-budget .....	2,411	2,340	2,470
Off-budget .....	431	460	471
<b>Receipts:</b>			
Unified .....	2,407	2,540	2,662
On-budget .....	1,799	1,906	1,988
Off-budget .....	608	634	674
<b>Outlays:</b>			
Unified .....	2,655	2,784	2,902
On-budget .....	2,233	2,333	2,439
Off-budget .....	422	451	463
<b>Surplus/Deficit(-):</b>			
Unified .....	-248	-244	-239
On-budget .....	-434	-427	-451
Off-budget .....	186	183	212

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 Fed-

eral 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, the Telecommunications Development Fund, and the transactions of Electric Reliability Organizations (EROs) established pursuant to the Energy Policy Act of 2005.

The budget also reclassifies as governmental the collections and spending by the affordable housing program (AHP) funds created by the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) 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 \$2.7 billion to the AHP funds, of which \$1.9 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.

### 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. However, in some instances, 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 of this volume, “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 of this volume, "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 long-standing 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 exam-

ple, 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 encom-

passes 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 authorizing 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 *unobli-*

*gated balance*. Most of this budget authority is earmarked for specific uses and is not available for new programs. A small part may never be 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.<sup>2</sup>

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

<sup>2</sup>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.

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 2007 appropriations act extends the availability of unobligated budget authority that expired at the end of 2006, new budget authority would be recorded for 2007.

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 legally 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).

## 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 semi-

annual 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.

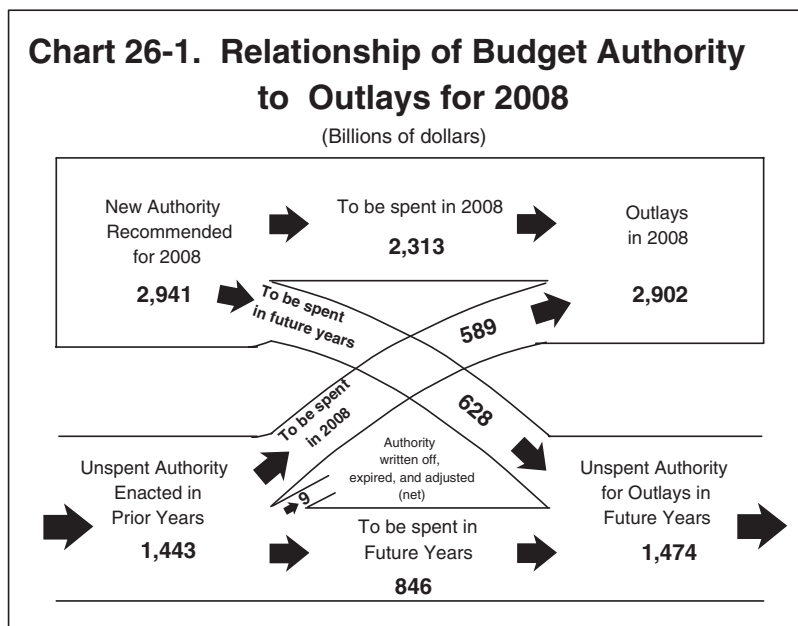
For Federal credit programs, outlays are equal to the subsidy cost of direct loans and loan guarantees and are recorded as the underlying loans are disbursed (see FEDERAL CREDIT below).

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 2008 will be obligated or spent in 2008. 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, \$2,313 billion of outlays in 2008 (80 percent of the outlay total) will be made from that year's \$2,941 billion total of proposed new budget authority (a first-year spendout rate of 79 percent). Thus, the remaining \$589 billion of outlays in 2008 (20 percent of the outlay total) will be made from budget authority enacted in previous years. At the same time, \$628 billion of the new budget authority proposed for 2008 (21 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.



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 a little over one-third (\$1,017 billion in 2006) of total outlays for a fiscal year are discretionary and the remaining nearly two-thirds (\$1,639 billion in 2006) are mandatory spending and net interest. Such a large portion of total spending is nondiscretionary because authorizing legislation determines net interest (\$227 billion in 2006) and the spending for a few programs with large amounts of spending each year, such as Social Security (\$544 billion in 2006) and Medicare (\$325 billion in 2006).

The bulk of mandatory outlays flow 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.<sup>3</sup> 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 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<sup>3</sup>. 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

<sup>3</sup>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.

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. The factors included in the other means of financing can either increase or decrease the Government’s borrowing needs (or decrease or increase its ability to repay debt). For example, the change in the Treasury operating cash balance is a factor included in other means of financing. Holding receipts and outlays constant, increases in the cash balance increase the Government’s need to borrow or reduce the Government’s ability to repay debt, and decreases in the cash balance decrease the need to borrow or increase the ability to repay debt. 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 2006, the Government borrowed \$237 billion from the public. This financed nearly all of the \$248 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 2006, the debt held by the public was \$4,829 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.)

### 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 (2006) 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 (2007) 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. For accounts that are funded by appropriations bills that have not been enacted, the current year estimates are the annualized amount provided by Public Law 109–289, Division B, as amended.

### Data for the Budget Year

The budget year column (2008) 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 (2009 through 2012) in order to reflect the effect of budget decisions on longer term objectives and plans.

### 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. For accounts that are funded by appropriations bills that have not been enacted, the baseline estimates are based on the annualized amount provided by Public Law 109–289, Division B, as amended.

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

**Accrual Method of Measuring Cost** means an accounting method that records cost when the liability is incurred. As applied to Federal employee retirement benefits, cost is recorded when the benefits are earned rather than when they are paid at some time in the future.

**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, receipts, and the surplus or deficit. 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.

**Continuing resolution** means an appropriation act that provides for the ongoing operation of the Government in the absence of enacted appropriations.

**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.

**Debt Held by the Public** means the cumulative amount of money the Federal Government has borrowed from the public and not repaid.

**Debt Held by Government Accounts** means the debt the Treasury Department owes to accounts within the Federal Government. Most of it results from the surpluses of the Social Security and other trust funds, which are required by law to be invested in Federal securities.

**Debt Limit** means the maximum amount of Federal debt that may legally be outstanding at any time. It includes both the debt held by the public and the debt held by Government accounts. When the debt limit is reached, the Government cannot borrow more money until the Congress has enacted a law to increase the limit.

**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.)

**Entitlement** refers to a program in which the Federal Government is legally obligated to make payments or provide aid to any person who meets the legal cri-

teria for eligibility. Examples include Social Security, Medicare, Medicaid, and Food Stamps.

**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 outlaid. (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.)

**Unified budget** includes receipts from all sources and outlays for all programs of the Federal Government, including both on- and off-budget programs. It is the most comprehensive measure of the Government's finances.

***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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