COMMITTEE FOR A RESPONSIBLE FEDERAL BUDGET U.S. Budget Watch

Analysis of the President's FY2010 Budget
May 19, 2009

Recently, the White House released its comprehensive FY2010 budget request. A follow-up to their February Budget Overview, this most recent document includes detailed proposals for each agency, along with "Analytical Perspectives," a description of all proposed spending cuts and program eliminations, and an updated set of summary tables. Also released was the Treasury Department's "Green Book," which compiles all tax proposals within the budget.

The budget includes an upward adjustment of deficit numbers, but tells the same basic story as in February (see http://www.usbudgetwatch.org/crfb-fy2010-budget): large and persistent structural deficits throughout and beyond the economic crisis. Among our main observations:

- Updated "technical adjustments" since February have increased projected deficits, making a bleak fiscal picture even worse. We expect that when "economic adjustments" are made this summer, the situation will deteriorate further. Given this, we urge the Congress and Administration to focus more on policies which reduce long-term deficits and less on those expanding programs or cutting taxes.
- The Administration deserves credit for identifying additional sources of revenue for their health care plan in light of new projections which show that their original policies would not achieve sufficient savings. We encourage them to make similar adjustments as needed in other policy areas.
- We appreciate that the President has kept his pledge to go line-by-line through the budget by proposing specific programs to cut or eliminate. However, unless he can accompany these cuts with tough discretionary spending controls, followed by tax and entitlement reform, this is more an issue of good governance than true fiscal discipline.
- Finally, we join the President in supporting the return of statutory PAYGO. But we believe that outside the context of the current crisis, *all* mandatory spending and tax policies, both new and renewed, should be subject to these rules.

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Overview

The President's FY2010 budget request is essentially a detailed version of the budget overview released in February. In a non-transition year, no such overview exists, as the President is required to submit his final budget request by the first Monday in February. Given the challenges of creating a budget within weeks of coming to office, however, the President released his budget in parts, with the final pieces submitted on May 11th. The budget serves as a blueprint of the President's priorities, just as Congress's "concurrent resolution" serves as the basis by which Congress constructs its appropriation bills.

The President's FY2010 budget includes several notable updates from the February budget overview. Since February, the Administration has revised its deficit projections. Deficits are now expected to reach $1.84 trillion in 2009 and $1.26 trillion in 2010 -- an increase of $89 billion and $87 billion, respectively, from the Administration's February estimates. Over ten years, the Administration projects a total deficit of $7.11 trillion – up $139 billion from their February projections. As a percentage of GDP, deficits are now projected to bottom out at 2.7 percent of GDP in 2015, as opposed to 3 percent in 2013; but they will rise to 3.4 percent of GDP, rather than 3.1 percent, by 2019.

Fig. 1: Outlays, Receipts and Deficits under Several Projections (in billions)

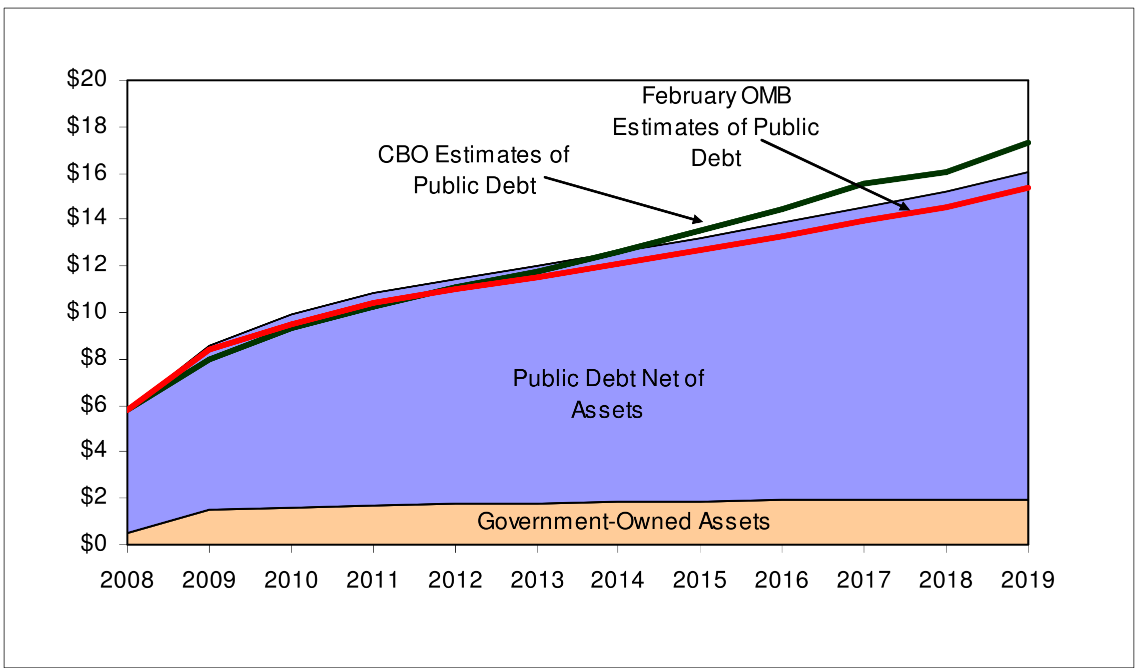
	2009	2010	2011	2012	2013	2014	2010-2014	2010-2019
RECEIPTS								
May FY2010 Budget	$2,157	$2,333	$2,685	$3,075	$3,305	$3,480	$14,879	$35,049
February Budget Overview	$2,186	$2,381	$2,713	$3,081	$3,323	$3,500	$14,997	$35,250
CBO Estimate of Overview	$2,159	$2,289	$2,586	$2,917	$3,095	$3,231	$14,118	$32,452
Concurrent Budget Resolution	$2,186	$2,322	$2,624	$2,856	$3,057	$3,298	$14,157	n/a
OUTLAYS								
May FY2010 Budget	$3,998	$3,591	$3,615	$3,633	$3,817	$4,016	$18,672	$42,157
February Budget Overview	$3,938	$3,552	$3,625	$3,662	$3,856	$4,069	$18,764	$42,219
CBO Estimate of Overview	$4,004	$3,669	$3,556	$3,575	$3,767	$3,979	$18,546	$41,723
Concurrent Budget Resolution	$3,879	$3,555	$3,541	$3,476	$3,639	$3,821	$18,031	n/a
DEFICIT								
May FY2010 Budget	$1,841	$1,258	$929	$557	$512	$536	$3,793	$7,108
February Budget Overview	$1,752	$1,171	$912	$581	$533	$570	$3,767	$6,969
CBO Estimate of Overview	$1,845	$1,379	$970	$658	$672	$749	$4,429	$9,270
Concurrent Budget Resolution	$1,693	$1,233	$916	$620	$581	$523	$3,874	n/a

Differences in projections are largely attributable to "technical changes" and, to a lesser extent, the inclusion of new legislation. These technical changes account for lower revenue assumptions as the result of new information, but do not incorporate any changes in macroeconomic estimates for GDP, inflation, employment, or other key statistics. The adjustments reduce tax revenue estimates by $36 billion for 2009, $28 billion for 2010, and $124 billion over ten years. Additionally, estimates for the eventual cost of the Troubled Asset Relief Program (TARP) have been raised by $46 billion (See http://www.usbudgetwatch.org/stimulus for up-to-date TARP numbers). Interest costs also increase as a result of more borrowing.

In addition, the Administration made several minor adjustments to their policy proposals, reflecting new economic and fiscal realities. For example, in light of lower projected funds for their health care reserve fund ($576 billion as opposed to $634 billion), the Administration proposed additional offsets so that their fund would include $635 billion of available funds. At the same time, the new budget would boost the FDIC's borrowing authority by $90 billion over the period 2009-2011, an amount that would ultimately be recouped through higher insurance premiums on banks.

While some projections and policies may have changed, the nation's underlying debt path has not. Regardless of which projection is used, public debt will grow rapidly and significantly over the next decade.

Fig. 2: Public Debt Projections for the President's Budget Request (in trillions)



Spending and Tax Policies

In total, the Administration's proposals increase the deficit by $7.1 trillion over ten years, as compared to the current-law baseline. The Congressional Budget Office (CBO) estimates that the February budget overview is significantly higher than OMB's due largely to its use of updated economic assumptions.

Because the President more or less offsets the costs of his new policies, most of this deficit increase comes from renewing existing policies – which the Administration includes in its "current policy" baseline. For example, they do not offset the renewal of the 2001/2003 tax cuts or the Alternative Minimum Tax (AMT) and Medicare physician payment patches. Additionally, they assume high costs for overseas operations.

Fig. 3: Tax Proposals (in billions)

Tax Proposal	2010-2014	2010-2019
Renew 2001/2003 Tax Cuts for Income Under $250,000	-$752	-$2,057
AMT Patch	-$203	-$576
Making Work Pay Credit	-$217	-$535
EITC and Child Tax Credit Expansion	-$34	-$92
Savings Incentives	-$15	-$60
American Opportunity Tax Credit	-$15	-$49
Corporate Tax Cuts	-$30	-$71
Other Tax Changes	-$31	-$80
Tax Cuts	***-$1,297***	***-$3,518***
Taxes on Oil and Gas Companies	$19	$48
Cap-and-Trade Revenue	$32	$87
Crack Down on Overseas Tax Havens	$23	$60
Reform Treatment of Foreign Deferred Income	$16	$43
Close Domestic Tax Loopholes	$9	$20
Modify Foreign Tax Credit	$231	$624
Close Other International Tax Loopholes	$34	$92
Revenue Raisers	***$365***	***$977***
Net Tax Reduction	**-$931**	**-$2,540**

Fig. 4: Spending Proposals (in billions)

Spending Proposal	2010-2014	2010-2019
Medicare Physician Pay Patches	-$131	-$300
Budgeting for Emergencies	-$8	-$50
Expand Student Loan Funding	-$37	-$116
Create Home Visitation Program	-$2	-$8
Expand Energy Assistance	-$2	-$4
Expand TANF, Unemployment, and TAA	-$14	-$30
Child Nutrition	-$5	-$10
Other Spending/Savings	-$148	-$444
Spending Increases	***-$350***	***-$962***
Defense Spending (including emergency/overseas operations)	-$68	$65
Reduce Farm Subsidies	$7	$17
Reform Private Student Loan Subsidies	$25	$48
Program Integrity Funding	$29	$48
FCC Auctions for Satellite Spectrum	$3	$6
Credit/Indirect Interest Effects	$147	$187
Other Mandatory Spending/Savings	-$12	$7
Spending Reductions	***$127***	***$378***
Net Spending Increase	**-$223**	**-$584**

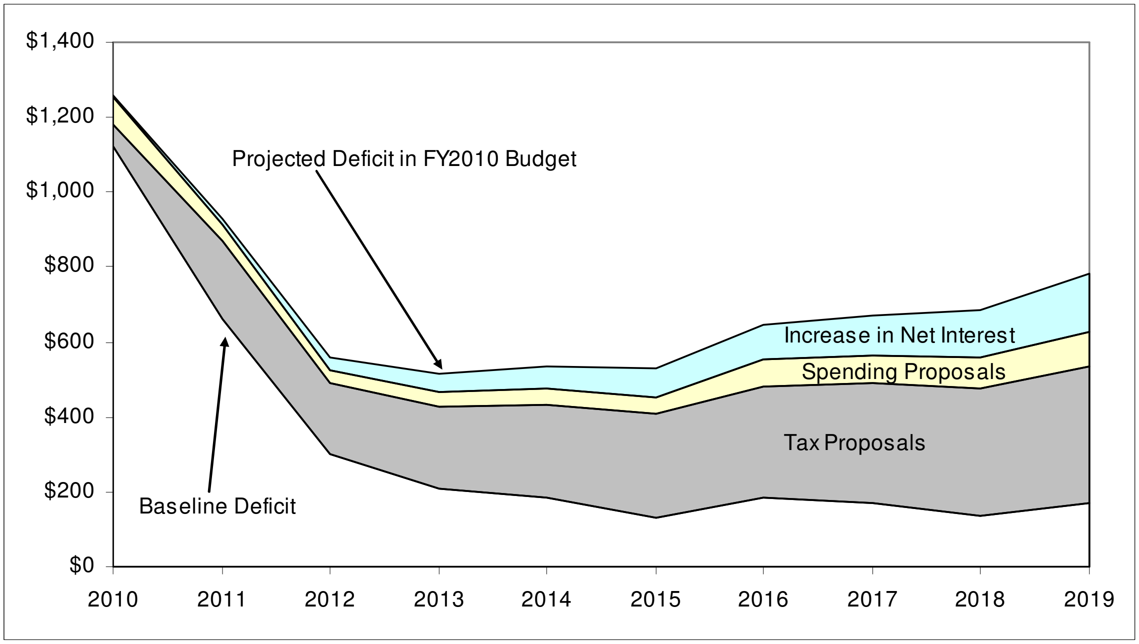
Fig. 5: Change to Deficit (in billions)

	2010-2014	2010-2019
BEA Baseline Deficit	-$2,476	-$3,259
Net Tax Reduction	-$931	-$2540
Net Spending Increase	-$223	-$584
Increase in Net Interest	-$165	-$726
Total Deficit	**-$3,795**	**-$7,109**

Note: In charts above, negative numbers indicate an increase in the deficit, positive numbers a decrease

Compared with a current-law baseline, tax cuts are the largest policy contributors to the deficit. Over ten years, new and renewed tax cuts will cost more than $3.5 trillion, while new tax provisions and increases will raise around $1 trillion. Non-interest spending will add less than $1 trillion to the deficit, and will be offset by roughly $380 billion in spending cuts. Net interest will also contribute significantly, adding over $700 billion to the deficit.

Fig. 6: Drivers of Increased Federal Deficit (in billions)



Terminations, Reductions, and Savings

Featured in this year's budget is a section on recommended program terminations and reductions. The proposed cuts affect 121 programs for approximately $17 billion in total savings during FY2010. Of the cuts, roughly 75 programs, or $11.5 billion, come from discretionary programs. Another 19 cuts, totaling roughly $4 billion, come from mandatory and tax savings.

Additional savings include 5 initiatives to improve program integrity -- reducing waste, fraud, and abuse – for a total of $1 billion in savings in 2010 and $50 billion over ten years. The Administration also proposes 22 "other savings" for which the actual amount to be saved is less certain.

By dollar amount, most discretionary savings come from defense cuts (around $9.5 billion) including the elimination of the F-22 Raptor aircraft, the new Presidential helicopter, and the Transformational Satellite program.

Nearly all mandatory cuts in FY2010 come from removing subsidies to private student lenders, with the money used to finance a student loan expansion. Over ten years, however, this cut makes up less than half of the President's mandatory savings ($41 billion out of $87 billion), with other large savings coming from eliminating tax preferences for oil and gas companies and cutting farm subsidies.

Based on number of cuts, three departments received the brunt of the impact. The Department of Agriculture received 17 cuts, mainly phase-downs of farm subsidy programs. The departments of Defense and Education meanwhile received 15 cuts each.

Fig. 7: Savings by Type (dollars)

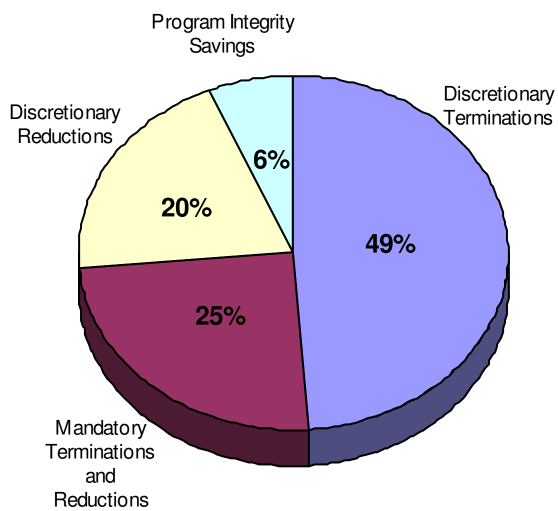


Fig. 9: Savings by Agency (dollars)

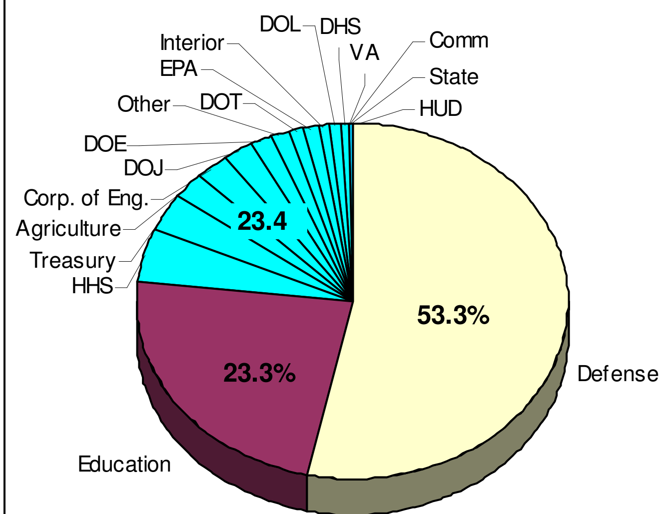


Fig. 8: Savings by Type (number)

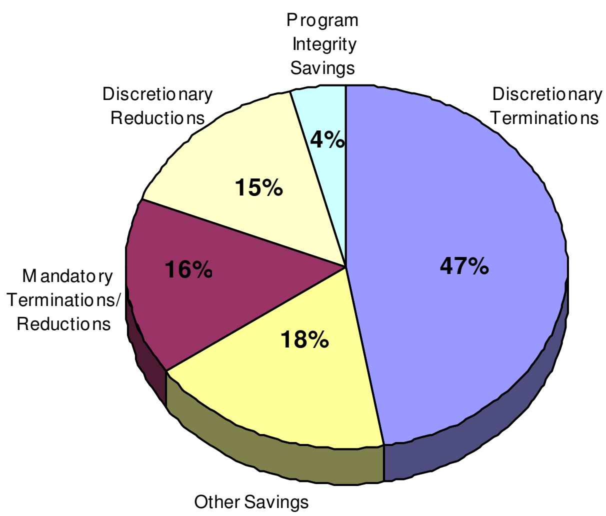
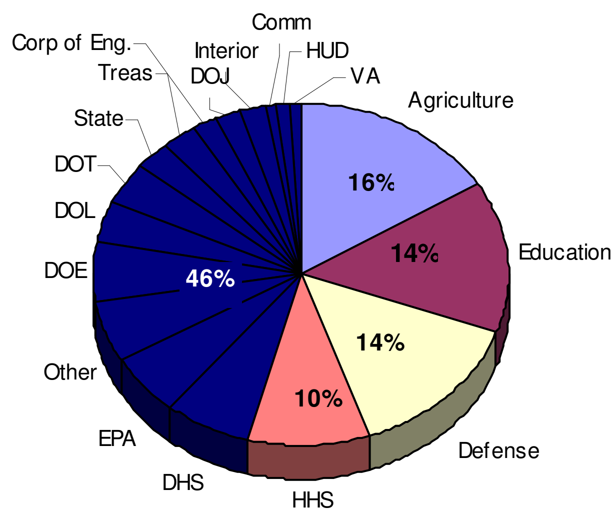


Fig. 10: Savings by Agency (number)



Note: Fig. 7 does not include "Other Savings" due to lack of specificity for savings estimates

In comparison with the Obama Administration's proposal of $17 billion in savings across 121 programs, the Bush Administration listed 151 different program cuts for $18 billion in savings in its FY2009 budget, and similar amounts in previous years. However, these cuts were only on the discretionary side, of which President Obama's 75 cuts total only $11.5 billion.

Despite proposing more cuts than the Obama Administration, President Bush saw limited success in eliminating or cutting government programs. For its FY2006 Budget, coming off a large electoral victory with a unified Congress and few spending pledges, the Bush Administration succeeded in achieving around 40% of its proposed cuts and saving roughly $6.5 billion. In the next two years, Congress enacted less than 15% of the Administration's proposed cuts, for savings of less than $2 billion a year.

Given this historical lack of success in eliminating programs, it is likely that President Obama will face significant resistance to his proposals.

Budget Reform Proposals

In addition to outlining the President's spending and tax priorities, the Administration's budget includes a number of proposals for budget process reform. First, the budget includes a recommendation for a statutory "pay-as-you-go" (PAYGO) provision requiring all new mandatory spending and tax cuts to be offset. Although PAYGO has existed as law through the 1990s, it expired in 2002, and was only re-adopted as a Congressional "rule" in 2007.

The Administration's proposal would enforce PAYGO through automatic sequestration of selected mandatory programs. However, the President would not use the standard current-law baseline which requires that legislative changes be revenue neutral. Instead, he would use the "current policy" baseline in his budget – which assumes the 2001/2003 tax cuts would be renewed, the AMT would be patched annually, and Medicare physician payment patches would continue. Furthermore, instead of applying PAYGO requirements to individual bills, the Administration would apply PAYGO rules on a year-by-year basis.

Other proposals for budget reform include a separate allocation to the Congressional appropriations committees for $1.9 billion in program integrity funding, a $29 billion limit on advance appropriations for FY2011, and an expedited system for rescission or cancellation of previously appropriated funds.

Health Care Reserve Fund

As in its February budget overview, the Administration set aside funds in this budget to pay for a portion of its health care plan. Originally, this health care "reserve fund" was supported by $634 billion in savings: $316 billion through reforms in Medicare and Medicaid, and $318 billion by limiting the tax rate for itemized deductions. Because of revised projections that these provisions would generate $7 billion and $51 billion less over ten years, respectively, the Administration made several adjustments to its plan.

Fig. 11: Projected Savings for Revised Health Care Reserve Fund (in billions)

Policy Proposals	2010-2014	2010-2019
Institute Competitive Bidding for Medicare Advantage	$47.6	$177.2
Increase Premiums for High-Income Enrollees Medicare Part D	$2.4	$8.1
Reallocate Medicare and Medicaid Improvement Funds	$23.2	$23.8
Encourage Hospitals to Reduce Readmission Rates	$2.5	$8.4
Create Hospital Quality Incentive Payments	$3.0	$12.1
Bundle Certain Medicare Payments	$0.8	$16.1
Reform Payments for Medical Imaging	$0.1	$0.3
Ensure Accurate Medicare Payments	$0.8	$2.1
Promote Cost-Effective Purchase of Medicaid Prescription Drugs	$8.5	$20.0
Promote Increased Use of Generic Drugs	**	$6.4
Expand Family Planning Under Medicaid	**	$0.1
Ensure Appropriate Medicaid Payments	$0.2	$0.6
Improve Medicare Home Health Payments	$12.2	$34.1
Medicare and Medicaid Savings	***$101.1***	***$309.1***
Limit Tax Rate for Itemized Deductions	$91.5	$266.7
*Expand Information Reporting to Reduce the Tax Gap and Improve Compliance	$4	$10.4
*Improve Business Compliance	**	$0.1
*Strengthen Tax Administration	$0.1	$0.2
*Expand Penalties for Tax Noncompliance	**	**
*Close Tax Loopholes for Financial Institutions and Products	$1.7	$4.2
*Close Tax Loopholes for Insurance Companies and Products	$4.9	$12.7
*Reform Tax Accounting Methods to Close Tax Loopholes	$4.1	$6.5
*Modify the Estate and Gift Tax Valuation Discounts	$8.6	$24.2
*Modify Alternative Fuel Mixture Credit	$0.7	$0.7
New Revenue	***$115.7***	***$325.6***
Total Reserve Fund	**$216.8**	**$634.7**

Total Figures May Not Add Exactly Due to Rounding
*Added since the February Budget Outline
**Amount is less than $50 million

To compensate for the $58 billion in lost savings, the Administration proposed new tax provisions totaling $59 billion, bringing the total size of the reserve fund to $635 billion. In particular, the Administration proposed initiatives to reduce the tax gap and close a number of tax loopholes. Altogether, the proposed reserve fund will now save $309 billion on Medicare and Medicaid reform and $326 billion on revenue-related policies. As the Administration has explained, these funds would represent a "down payment" on health care reform, as more offsets would likely be needed to fully fund the President's health care plan.

* * *

We are pleased that the President has changed his health care plan in light of new projections, and encourage him to make similar adjustments to the rest of his policies. When his budget is re-estimated with updated economic assumptions, we expect the fiscal picture to look considerably worse. Given that, the President should reduce the size of the commitments he has made and/or offer new proposals to offset their costs. In addition, we believe he must work with Congress to find offsetting measures to pay for the entirety of his health care plan, which is likely to cost considerably more than the $635 billion in his reserve fund.

These adjustments and changes, though, will not be enough. As the economy recovers and stabilizes, the President's proposed fiscal path results in far too much borrowing. Because he exempts a number of policies from being offset under his PAYGO proposal – particularly the renewal of the 2001/2003 tax cuts and continued patches for the AMT and Medicare physician payments – the President's agenda considerably increases structural deficits from the baseline, driving the national debt to unprecedented peacetime levels.

Although it is important to make efforts to cut wasteful or ineffective programs, the Administration's budget cuts will do little to reduce the massive structural deficits we face. To improve this situation, more cuts and terminations must be identified in all areas of government, on both the tax and spending sides. In particular, we would urge the President to address Social Security's long-term shortfalls, identify and pursue policies to significantly reduce Medicare's and Medicaid's costs over the long run, and fundamentally reform the tax code. Without these undertakings, we will fall short of fiscal stability.