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ANALYSIS OF THE PRESIDENT'S BUDGET FOR FY2013

THE PRESIDENT'S BUDGET INCREASES SPENDING, RAISES TAXES, AND OFFERS NO PLAN TO LIFT THE DEBT

February 24, 2012

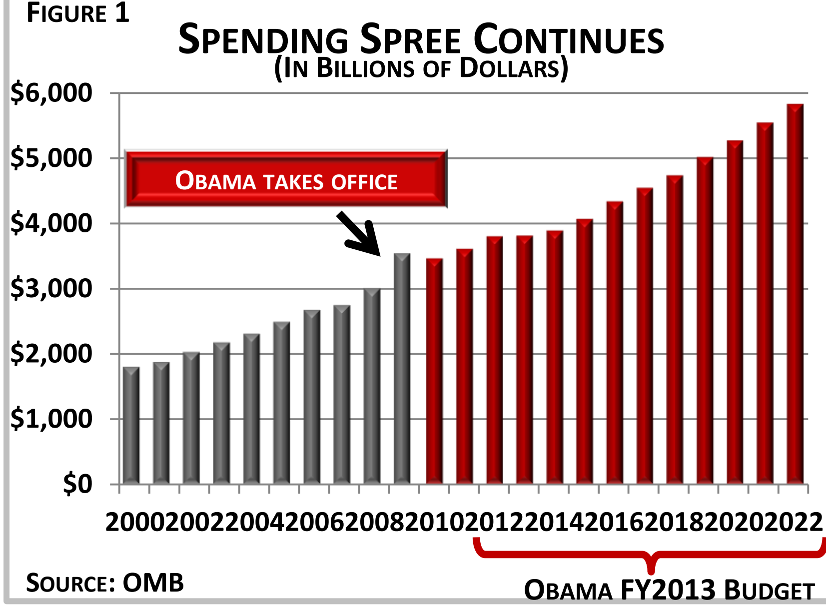
KEY POINTS:

- **The President's budget spends too much – a net spending increase of $1.5 trillion above current projections.**
- **The President's budget taxes too much – a net tax increase of $1.9 trillion above current projections.**
- **The President's budget borrows too much:**
  - **It adds over $11 trillion to the national debt.**
  - **Instead of cutting the deficit in half as promised, it delivers a deficit of over $1 trillion, the fourth in a row during this administration.**
- **The President's budget uses gimmicks to create the illusion of spending restraint and deficit reduction:**
  - **Claims credit for over $2 trillion in savings already in law;**
  - **Claims almost $1 trillion in "savings" that were never requested and never going to be spent; and**
  - **Makes numerous adjustments to its baseline, or "starting line," to improve results at the finish line.**
- **The President's budget offers no plan to lift the debt, thus putting the nation on a path to decline.**

Introduction

After four budget submissions, the President has failed to use his term to confront the nation's most pressing fiscal and economic challenges. His fourth budget advances policies that dangerously accelerate the fiscal crisis America faces. His budget fails to reduce the fast-rising debt, permanently entrenches unsustainable levels of government spending, and erects new barriers to upward mobility. His plan stifles economic growth, threatens the health and retirement security of millions of Americans, and commits the next generation to a diminished future.

FIGURE 1



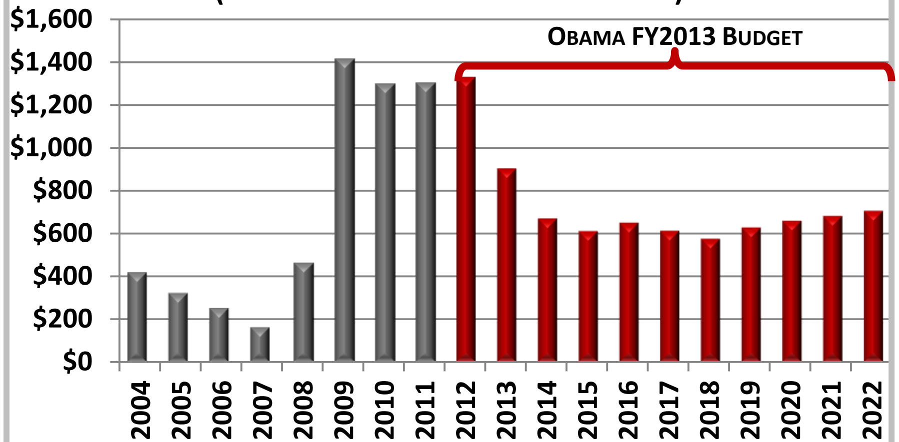
Summary

Spending: President Obama's budget includes more of the same failed spending policies he has pursued since taking office – policies that would worsen the nation's fiscal crisis and speed the country to bankruptcy. Three years after the passage of the President's trillion-dollar spending stimulus, the President is at it again, calling for more wasteful spending taken from workers' paychecks or borrowed from abroad. The massive spending increases are greater than the few proposed spending reductions, for a net spending increase of $1.5 trillion over ten years.

Table 1 – Major Tax Increases Included in the President's Budget (figures in billions)

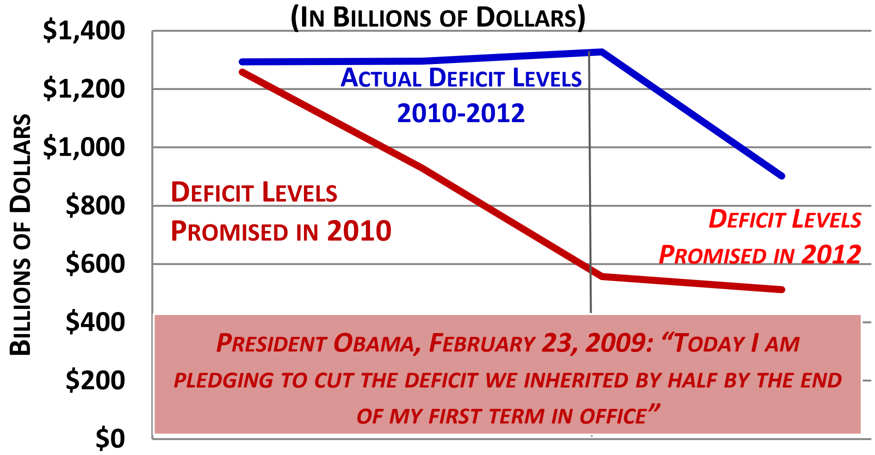
Proposals	10-year Total
Sunset Upper Income Tax Provisions from 2001/2003	+849
Additional Taxes on Upper Income Filers	+584
Increase Estate and Gift Tax	+143
Reform U.S. International Tax System	+148
Eliminate Fossil Fuel Tax Preferences	+30
Taxes on Financial Services & Insurance Industry	+19
Reduce the Tax Gap	+12
Other Revenue Changes and Loophole Closers	+142
Total	**+1,926**

FIGURE 2 DEFICIT UNDER OBAMA BUDGET
(DEFICIT LEVELS IN BILLIONS OF DOLLARS)



SOURCE: OMB

FIGURE 3 PRESIDENT'S BROKEN PROMISE ON DEFICIT
(IN BILLIONS OF DOLLARS)



SOURCE: OMB

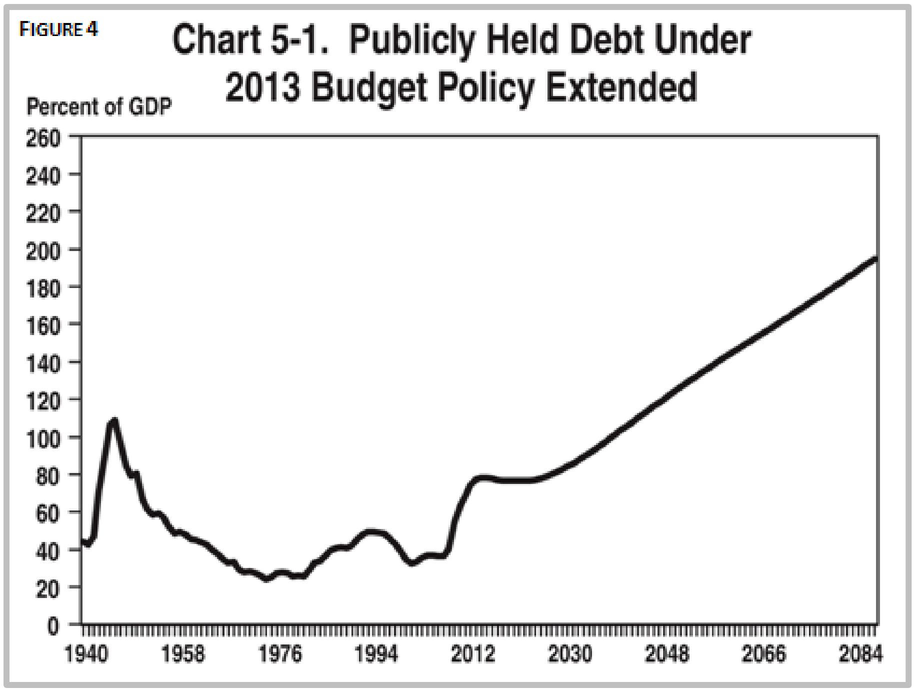
Taxes: The President's budget imposes a heavy cost for its commitment to intrusive government – diminishing economic opportunity by imposing the largest tax hike in American history. This budget imposes $1.9 trillion in new taxes and adds new complexities to an already broken tax code.

Deficits: When he first took office, the President promised to cut the deficit in half by the end of his term.[1] Four straight trillion-dollar deficits later, he hasn't even come close. His latest budget projects a deficit of $1.3 trillion for FY2012.

While some had hoped that the President might take some responsibility for breaking his promise, he has offered only excuses – for example, that the recession turned out to be deeper than he realized.[2] But this excuse does not stand up to scrutiny: As recently as February of last year, well after the full extent of the recession was known, the President emphatically stated that he planned to keep his promise to cut the deficit in half, and provided projections to prove it.[3] This pattern – promising one thing, then delivering another – casts doubt on the President's latest round of promises and projections, which show deficits falling over time.

Debt: Under President Obama's watch, the federal government's total debt has surpassed the size of the economy – undermining job creation today and threatening a debt crisis tomorrow. According to its own numbers, the President's budget ignores the drivers of the debt, bringing America perilously close to a European-style crisis.

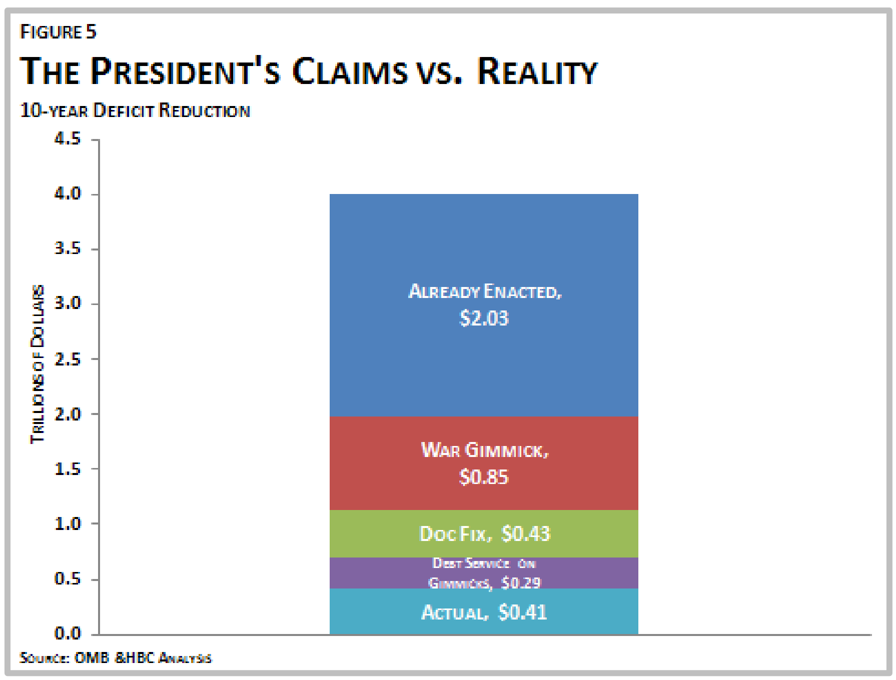
[1] Allen, Mike. "Obama vows to cut huge deficit in half." *Politico,* February 22, 2012. http://www.politico.com/news/stories/0209/19124.html
[2] Interview with Fox affiliate WAGA-TV, February 14, 2012. http://www.realclearpolitics.com/video/2012/02/14/obama_on_failed_promise_to_cut_deficit_in_half_recession_turned_out_to_be_a_lot_deeper.html
[3] Presidential Press Conference on the Fiscal Year 2012 Budget, February 15, 2012. http://www.whitehouse.gov/photos-and-video/video/2011/02/15/presidential-press-conference-2012-budget



When confronted with Figure 4, which is a chart from the President's own budget, Treasury Secretary Timothy Geithner admitted, "We're not coming before you to say we have a definitive solution to our long-term problem. What we do know is we don't like yours." This line perfectly illustrates the President's approach to leadership on the nation's fiscal problems – wait for someone else to propose a plan, and then attack it.

Budget Gimmicks: The President's budget inflates its deficit-reduction claims by taking credit for over $2 trillion in savings already in law and the exploitation of discredited budget gimmicks, including almost $1 trillion in "savings" from money that was never requested and never to be spent in Iraq and Afghanistan. Also, when it comes to measuring tax rates, Pell grants, and the Medicare "doc fix" (scheduled cuts to doctors' reimbursements that are systematically avoided), his budget adjusts the starting line to satisfy his finish line.

Broken Promises: By failing to put forward long-overdue reforms, his budget allows Social Security to fall into bankruptcy (imposing an across-the-board 23 percent cut on seniors) and gives unaccountable government bureaucrats control over cutting Medicare in ways that would result in denied care for seniors. No credible action is taken to lift the crushing burden of debt. This President's empty promises are quickly becoming broken promises for millions of Americans.



Analysis[4]

A deeper look at the President's budget confirms that his policies would increase spending, raise taxes, add trillions to the debt, allow Medicare and Social Security to go bankrupt, and make deep reductions in defense spending that would put the nation's security at risk.

[4] All the data used in this analysis comes from the President's budget and other supporting materials produced by the administration. The Congressional Budget Office will re-estimate the President's budget and produce a separate analysis in March. In the past, CBO has estimated higher deficits than reflected in the administration's budget projections and other supporting materials.

Table 2 – The President's Budget (figures in billions and as % of GDP)[5]

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2013-2022
Budget Totals in Billions of Dollars:												
Receipts	2,469	2,902	3,215	3,450	3,680	3,919	4,153	4,379	4,604	4,857	5,115	40,274
Outlays	3,796	3,803	3,883	4,060	4,329	4,532	4,728	5,004	5,262	5,537	5,820	46,959
Deficit	1,327	901	668	610	649	612	575	626	658	681	704	6,684
Debt held by the public	11,578	12,637	13,445	14,198	14,980	15,713	16,404	17,137	17,897	18,678	19,486	
Total Debt Subject to Limit	16,334	17,532	18,485	19,412	20,379	21,315	22,235	23,143	24,069	25,002	25,936	
Gross domestic product (GDP)	15,602	16,335	17,156	18,178	19,261	20,369	21,444	22,421	23,409	24,427	25,488	
Budget Totals as a Percent of GDP:												
Receipts	15.8%	17.8%	18.7%	19.0%	19.1%	19.2%	19.4%	19.5%	19.7%	19.9%	20.1%	19.2%
Outlays	24.3%	23.3%	22.6%	22.3%	22.5%	22.2%	22.0%	22.3%	22.5%	22.7%	22.8%	22.5%
Deficit	8.5%	5.5%	3.9%	3.4%	3.4%	3.0%	2.7%	2.8%	2.8%	2.8%	2.8%	3.3%
Debt held by the public	74.2%	77.4%	78.4%	78.1%	77.8%	77.1%	76.5%	76.4%	76.5%	76.5%	76.5%	
Total Debt Subject to Limit	105%	107%	108%	107%	106%	105%	104%	103%	103%	102%	102%	

Spending

The President's budget is projected to spend about $3.8 trillion per year in both 2012 and 2013, and nearly $47 trillion over the next ten years. The FY 2013 level of spending maintains spending at a level that has soared over the past four years. Spending rose by $1 trillion from 2007 to 2012. During this period, the burden of federal government spending on the economy rose from 19.7 percent of GDP to 24 percent of GDP – well above the 40-year historical average of around 21 percent. With a projected decline in temporary spending, such as unemployment insurance and war funding, spending moderates to 22 percent and then begins its upward climb again, reaching 22.8 percent by the end of the ten-year budget window. When gimmicks are removed, the President's ten-year spending request is about $1.5 trillion higher (3.4 percent) than his own current-policy baseline (see Table 4 below).

Taxes

Despite a $287 billion increase in revenues (12 percent) that the administration projects will be realized this year under current law and current tax rates, the President's budget includes a net tax increase of about $1.9 trillion over ten years.

Expiration of 2001/2003 Tax Provisions for Upper-Income Filers: The budget would increase the top two income tax brackets from 33 percent to 36 percent and from 35 percent to 39.6 percent, respectively, starting next year. The effects of marginal tax-rate increases would impose economic harm on all Americans. Three quarters of the nation's small businesses file as individuals, meaning that higher individual rates make it harder for these vital enterprises to compete. Small businesses are responsible for almost two thirds of the jobs created in the United States in the past 15 years, and almost 50 percent of small-business profits are taxed at the top two rates.[6] [7] The President's budget proposes to raise rates on the most successful job creators in America.

If the 2001/03 tax provisions expire, as they are scheduled to do after 2012, and the new health care taxes kick in under current law, the top marginal income tax rate will rise from 35 percent to an effective rate of nearly 45 percent in 2013 (see Table 3 to right).

[5] Source: Table S-1, Budget of United States Government, FY 2013, page 205.
[6] Headd, Brian. *An Analysis of Small Business and Jobs*. Small Business Administration. Office of Advocacy. March 2010. http://www.sba.gov/advocacy/849/7642
[7] Internal Revenue Service. *Statistics of Income*. "Table 1.4 All Returns: Sources of Income, Adjustments, and Tax Items, by Size of Adjusted Gross Income, Tax Year 2008" http://www.irs.gov/pub/irs-soi/08in14ar.xls

Table 3 – Tax Rates Under Administration Policies

INCOME	
TOP STATUTORY RATE, 2011	35.0%
EXPIRATION OF 2001/03 LOWER RATES, 2013	39.6%
PEP/PEASE PROVISIONS RE-INSTATED, 2013	41.6%
NET 2.3% MEDICARE TAX ON WAGES/SALARY	43.9%
0.9% NON-DEDUCIBLE MEDICARE TAX, 2013	44.8%
DIVIDENDS	
TOP STATUTORY RATE, 2011	15.0%
TAX DIVIDENDS AT ORDINARY INCOME RATE, 2013	39.6%
PEP/PEASE PROVISIONS RE-INSTATED, 2013	41.6%
NEW 3.8% TAX ON INVESTMENT INCOME, 2013	45.4%
CAPITAL GAINS	
TOP STATUTORY RATE, 2011	15.0%
EXPIRATION OF LOWER 2003 RATE, 2013	20.0%
NEW 3.8% TAX ON INVESTMENT INCOME, 2013	23.8%

The President's budget would also increase the tax rate on capital gains from 15 percent to 20 percent for households making more than $250,000 ($200,000 for individuals) and would tax dividends at ordinary income tax rates (as high as 39.6 percent) – thus raising taxes on investment capital at a time when it is badly needed to sustain the weak recovery, and raising taxes on investment income at a time when the Federal Reserve's sustained zero-interest-rate policy is already punishing savers. Sustainable economic growth flows from savings and investment, not borrowing and consumption.

The President's budget also restores the phase-out of personal exemptions and itemized deductions (the so-called PEP and Pease provisions) for upper-income filers and would limit the value of deductions against income. Altogether, the President hopes to take an additional $849 billion in revenue over ten years through tax increases on upper-income filers. In addition, the budget would reduce eligible tax credits and deductions for this cohort, which the administration projects would raise an additional $584 billion.

The budget also includes extension of the 2001/2003 tax policies for lower- and middle-income filers; however, the deficit impact of this policy is included in the President's baseline, not shown as new policy. Here the President's budget is at odds with his party's rhetoric: Democrats often argue that the "cost" of making current tax rates permanent is something the nation "cannot afford." But for the purposes of measuring deficit reduction, the President's budget treats current tax policy as permanent. In other words, it counts the expiration of the top two rates as a new tax increase, and it does not treat the extension of the rest of the 2001/2003 rates as a "cost" that adds to the deficit. If the President's budget is compared to a current-law baseline that assumes 1) that the spending reductions mandated by the Budget Control Act will occur as planned and 2) that the 2001/2003 tax relief will expire on schedule, then the President's budget increases the deficit by $3.7 trillion over ten years.[8]

Increases in Estate and Gift Tax: Under the President's budget, the estate tax would revert back to 2009 levels (an exemption level of $3.5 million and a tax rate of 45 percent on assets), and rules governing gift taxes would be modified. All together, this proposal seeks to raise $143 billion over ten years.

New Tax Credits for Manufacturing: The budget proposes tax preferences for locating jobs and business activity in the United States. The administration also proposes a new Manufacturing Communities tax credit and enhances and makes permanent the research and experimentation tax credit – a tax preference used by manufacturers. These credits and incentives would reduce tax revenue by $121 billion over ten years.

[8] Table S-1 (page 205) shows the President's budget producing a deficit of $6.684 trillion over ten years. In table S-8 (page 216) of the President's budget, the administration shows a current-law (Budget Enforcement Act, or BEA) baseline deficit of $4.718 trillion for that same period. Compared to the administration's current-law baseline, the President's budget increases the deficit by $1.996 trillion, However, the administration has constructed the current-law baseline to exclude $1.712 trillion in spending reductions that are mandated through current law: the Budget Control Act's (BCA) caps ($746 billion) and the sequester ($966 billion). Including the deficit impact of the BCA in the current-law baseline as CBO does, the administration's budget increases the deficit by $3.678 trillion over ten years relative to a current-law baseline.

Fee on Financial Institutions: The administration would impose a "financial crisis responsibility fee" on certain financial institutions to penalize them for their "excessive risk-taking" during the financial crisis and subsequent damage to the economy. In calculating its budget's ratio of spending cuts to tax increases, the administration counted this proposal as a spending reduction. However, the administration's budget itself properly classifies the money raised as new revenue – $61 billion over ten years.

Reform Elements of U.S. International Tax System: The administration would alter the tax treatment of U.S. multinationals operating abroad. The proposals would generally have the effect of raising the tax rate on these entities. For instance, the value of foreign tax credits, which are used to offset U.S. income revenue already taxed abroad, would be reduced and the deduction for interest expenses on certain income would be deferred. These proposals seek to raise $148 billion over ten years.

Eliminate Fossil Fuel Tax Preferences: The administration would roll back a number of tax incentives for producing energy domestically, such as repealing the expensing of intangible drilling costs. These proposals seek to raise $30 billion over ten years.

Deficits

The deficit for 2012 is projected to be $1.3 trillion – the fourth year in a row of deficits over the trillion-dollar mark. The President promised that he would cut the 2009 deficit ($1.4 trillion) in half by the end of his term, which would have resulted in 2012 deficit of about $700 billion. His latest budget request, however, shows he will have achieved only about $100 billion of deficit reduction from 2009 levels by the time his term ends. The administration projects the FY2013 deficit is projected to be $901 billion and the ten-year cumulative deficit is projected to be $6.7 trillion – even with savings from the Budget Control Act and tax increases on upper-income individuals included. In the past, the administration's out-year projections have proven to be too optimistic.

The President's supporters have claimed his budget achieves over $4 trillion in deficit reduction. This claim can only be satisfied if savings from the previously enacted Budget Control Act and future-year war spending – a well-known budget gimmick – are included, and if several unpaid-for spending increase adjustments are made to his baseline. See the section on budget gimmicks below for a full discussion of the President's hidden spending and budget tricks.

Debt

The President's budget projects debt-held-by-the-public will be $11.6 trillion (74 percent of GDP) by the end of 2012 and gross debt will be $16.3 trillion (105 percent of GDP). These figures represent debt increases of $5.3 trillion and $5.7 trillion, respectively, since the day President Obama took office. Debt held by the public and gross debt were $6.3 trillion (45 percent of GDP) and $10.6 trillion (76 percent of GDP), respectively, on the day President Obama was inaugurated.

For the sake of comparison, the European Union calls on its countries to keep deficits below 3 percent of GDP and debt below 60 percent of GDP. This year's deficit under the President's budget will be 8.5 percent of GDP, above the FY2011 level for every country in the Eurozone except Greece and Ireland.

The administration projects that by balancing the budget excluding net interest expense (known as "primary balance"), its budget will stabilize debt held by the public (i.e., debt owned by outside investors rather than the government itself) as a share of GDP by 2022 due to projected economic growth over the next ten years. However, this focus on "primary balance" can be misleading.

For one thing, the debt burden will rise to 76.5 percent of GDP at the end of the decade, more than twice the level of debt in the year before the financial crisis (36.3 percent in FY2007) and the average for the 40 years prior to the financial crisis (36.5 percent from 1963-2007). At these elevated levels, debt will be at the highest level as a share of the economy since the late 1940s, when the government routinely ran budget surpluses to reduce the huge accumulation of debt acquired during World War II. Second, it obscures the fact that the President's budget never actually reaches balance: Debt held by the public is projected to increase by $9 trillion over the next ten years. And finally, those debt projections are contingent on interest rates for ten-year Treasury bonds averaging a little over 4.5 percent, well below the average interest rate on ten-year bonds in either the 1980s or 1990s. CBO has estimated in the past that if interest rates were instead to rise to the higher rates experienced in the past, deficits would be $1 trillion to $5 trillion higher over the ten-year period.[9]

Budget Gimmicks

The President's supporters have claimed the budget would result in deficit reduction anywhere between $3.2 trillion and $5.3 trillion. Most recently, the President's chief of staff claimed the budget reduced deficits by $4 trillion. When budget gimmicks and baseline adjustments are removed, the real deficit reduction figure is about $413 billion – only 10 percent of the $4 trillion claim.

Also, administration officials have claimed that their budget achieves a ratio of $2.5 in spending cuts to $1 in tax increases, but they are only able to reach these numbers by 1) using gimmicks, 2) reclassifying revenue increases as spending reductions, and 3) claiming savings that are not in their budget – namely, the nearly $2 trillion in spending cuts that were enacted last year. If these gimmicks are stripped out, then this budget increases taxes by $1.9 trillion and increases spending by $1.5 trillion. This budget does not make any net spending cuts. An accurate assessment would be that the administration *increases* spending by 78 cents for every dollar in tax increases.

The largest gimmick in the budget is nearly $848 billion in "savings" from winding down the wars in Iraq and Afghanistan – money that was never requested and never going to be spent in the first place. None of the bipartisan deficit-reduction plans that the administration is comparing its budget to – the The Bowles-Simpson Commission, the Rivlin-Domenici plan, and the Senate Gang of Six plan – used inflated war spending to claim deficit reduction. In addition, the Committee for a Responsible Federal Budget has called this savings claim a "gimmick."[10] Furthermore, CBO Director Douglas Elmendorf has stated flatly that "there is no 'OCO fund' set aside in the Treasury from which resources can be drawn in future years."[11]

The administration also included numerous adjustments to its baseline for unpaid-for spending increases, including $429 billion for a permanent adjustment to current-law reductions in Medicare reimbursements (the doc fix) and $50 billion for Pell grants. Table 4 below shows the revenue, spending and deficits under the President's budget with all gimmicks removed.

[9] Congressional Budget Office, letter to Congressman Paul Ryan, June 30, 2009. http://www.cbo.gov/sites/default/files/cbofiles/ftpdocs/104xx/doc10416/ryanletterinterestrates.pdf

[10] Committee for a Responsible Federal Budget, "CRFB Reacts to the President's FY 2013 Budget," February 13, 2012. http://crfb.org/sites/default/files/crfb_reacts_to_presidents_fy2013_budget_0.pdf

[11] Elmendorf, Douglas. "Can Proposed Reductions in Future War-Related Spending Be Used To Offset Proposed Deficit Increases in Other Areas?" February 1, 2012. http://cboblog.cbo.gov/?p=3237

Table 4 – Revenues, Spending, and Deficits in the President's Budget with Gimmicks Removed (figures in billions)[12]

Revenues (Taxes)	FY 2013-22
OMB "Adjusted baseline"	38,391
President's budget	40,274
Net Tax increase	+1,883
Spending (Outlays)	
OMB "Adjusted baseline"	47,053
President's budget	46,959
Claimed spending reduction	-94
Remove gimmicks	
Remove war savings	+848
Add cost of doc fix	+429
Add cost of Pell grants	+50
Debt service (@18%)	+239
Total gimmicks	+1,566
Actual spending increase (without gimmicks)	+1,472
Deficits	
OMB "Adjusted baseline" deficits	8,663
Adjusted baseline deficits without gimmicks	7,097
President's budget deficits	6,684
Deficit reduction with gimmicks	-1,979
Deficit reduction without gimmicks	-413

The Sequester

The President's budget reflects the cost of negating the automatic $1.2 trillion sequester mechanism enacted in the Budget Control Act (BCA), but it does not make a specific proposal to turn the sequester off. Instead, it appears that the administration "pays for" the sequester's assumed savings with tax increases and spending cuts elsewhere within the budget.

The President's budget appears to be below the FY2013 discretionary cap by $4 billion. However, this merely reflects a proposal to move $4 billion of transportation-related spending from the discretionary side of the budget to the mandatory side.

The Economy

The administration expects real GDP to grow by 2.7 percent this year, rising to 3.0 percent in 2013 – roughly 0.5 percentage points higher than the *Blue Chip* forecast in both years. Even with large tax increases and no plan to address the drivers of federal debt, the administration projects real GDP growth of 4.1percent in 2014. Despite this healthy growth rate, the administration expects that the decline in the unemployment rate will be slow and gradual. By their projections, the rate doesn't dip below 8 percent until late 2014, and doesn't fall below 6 percent until late in

[12] The administration uses an "Adjusted Baseline" to calculate the deficit reduction achieved in the President's budget. Table S-8 (page 216) includes a crosswalk from the current-law baseline (Budget Enforcement Act or BEA baseline) to their adjusted baseline. Table S-4 (page 208) displays their adjusted baseline by category. The revenue level proposed in the President's budget (Table S-1) is $1.883 trillion higher than the revenue level in the adjusted baseline over ten years. The administration's estimate of war "savings" can be found in table S-2 (page 206).

the decade (2017) and never falls below 5.5 percent over the next ten years. In contrast, the unemployment rate was 4.6 percent in 2007, the year before the financial crisis. These economic projections again reveal a vast divide between the President's promises and the President's dismal results.

The administration believes that sluggish demand and economic slack will help to contain inflation at roughly 2 percent per year, slightly below CBO's forecast and the *Blue Chip* consensus. As the economic recovery takes hold, interest rates are expected to rise back to more normal levels in the coming years. The ten-year Treasury note, which is below 2 percent currently, will rise back to 5.0 percent in the medium and longer-term. Table 5 below shows a comparison of key economic assumptions from the President's budget, CBO, and *Blue Chip*.

Table 5 – Comparison of Key Economic Assumptions

	Percent Change		*Average*
	2012	**2013**	**2013-2022**
Real GDP Growth			
President's Budget	2.70	3.00	3.20
CBO	2.20	1.00	2.97
Blue Chip*	2.20	2.60	2.65
Consumer Price Index			
President's Budget	2.20	1.90	2.06
CBO	1.70	1.50	2.04
Blue Chip*	2.10	2.10	2.43
Unemployment Rate	*Annual Average Percentage*		
President's Budget	8.90	8.60	6.34
CBO	8.80	9.10	6.43
Blue Chip*	8.70	8.30	6.59
10-Year Treasury Note			
President's Budget	2.80	3.50	4.74
CBO	2.30	2.50	4.24
Blue Chip*	2.30	3.00	4.57

* Figures for 2012 and 2013 are from the January 2012 Blue Chip forecast. Subsequent years are from Blue Chip's long-term projections released in October 2011.

Defense

The President's budget requests a total of $639.1 billion for FY2013 for the national defense budget function (Function 050) including both the base budget and funding for the ongoing Global War on Terrorism. The base budget request is $554.5 billion for national defense of which $525.4 billion is for the Department of Defense (DOD). The remainder funds the nuclear weapons complex at the Department of Energy and a variety of other national-security-related agencies. The request for DOD's costs for the Global War on Terrorism is $88.5 billion. Over the ten-year budget window, the defense budget request is $487 billion below the amounts requested by the President for defense last year. This is 4.2 percent below the CBO baseline (without adjustments for the Budget Control Act) over this period.

Base Defense Budget: The base budget request for DOD is $5.2 billion (1 percent) below the enacted level for FY2012. Using the administration's inflation assumptions, this represents a 2.5 percent real cut in funding for DOD. Over the ten-year window, the budget request reflects a major change in defense strategy announced by Secretary Panetta in January. The heart of the administration's new strategy is the assumption that the United States will not need to engage in large-scale, protracted stability operations of the kind that have characterized military operations for the past decade. Consistent with this assumption, DOD is proposing to reduce military end-strength by 1.4

percent this year and by 5.5 percent by 2017. The bulk of the reductions will be in Army and Marine Corps end-strength and will leave both services at approximately the same sizes they were in 2001.

The administration is also proposing significant reductions in force structure:

- The Army will lose at least eight of its 45 active component brigades and possibly more depending on a Service Review.
- The Navy will retire seven cruisers and two dock landing ships (used to support Marine amphibious operations) and abandon its previous goal of achieving a 313-ship fleet.
- The Marine Corps will eliminate an infantry regiment headquarters, five infantry battalions, an artillery battalion, four tactical air combat squadrons, and one combat logistics battalion.
- The Air Force will lose six fighter squadrons, 123 attack aircraft, 150 air transport and tanker aircraft, and 30 intelligence, reconnaissance, and surveillance aircraft.

The budget also delays and restructures several major procurement programs including the Joint Strike Fighter, the Army's major modernization program the Ground Combat Vehicle, and the replacement for the U.S. Navy's ballistic missile submarine. Delays and program restructurings of this sort have historically led to increased overall program cost even as they appear to save money within the five-year Future Years Defense Program that DOD uses. The budget request also includes a proposal to increase cost-sharing for some beneficiaries of the military's health care system, although not those on active duty.

In addition to the reductions for DOD proposed in the President's budget, the Budget Control Act's sequester mechanism would cut DOD by another $495 billion over ten years. While the administration assumes the sequester is "turned off," the budget does not include a discrete proposal to do so. Absent enactment of such a proposal, the defense budget will be reduced by 10 percent on January 2, 2013.

War Funding: The President is requesting a total of $96.7 billion for conduct of the Global War on Terrorism (GWOT) in FY2013, which the administration refers to as "Overseas Contingency Operations" (OCO), down from the $126.5 billion provided for these purposes in FY2012. The reduced request reflects the withdrawal of U.S. forces from Iraq and the ongoing reduction in the size of the U.S. military presence in Afghanistan. Under the President's announced policy, the United States is scheduled to fully reverse the surge in forces in Afghanistan by September 2012 and to transfer the lead for security operations to Afghan forces by 2014. Secretary Panetta has recently suggested that the transition to an Afghan-led security mission could take place as early as 2013, which could further reduce expected war costs.

The GWOT request has two components: $88.5 billion for the Department of Defense and $8.2 billion for the State Department, USAID, and other civilian agencies directly engaged in the integrated civil-military campaign. Under the Budget Control Act, funding that is designated for the war is added on top of the caps on total discretionary spending. For that reason, funding inappropriately designated as being for the war is a potential way around complying with the discretionary caps.

Medicare and Medicaid

The budget proposes to increase net Medicare spending over the next ten years by $135 billion. Within this figure, $438 billion of new spending is added to prevent scheduled cuts in reimbursements to physicians (i.e., the doc fix), which is partially offset by $300 billion in cuts elsewhere in the program. Of this amount, $268 billion are cuts to providers, which is in addition to the more than $500 billion in cuts this group already faces due to the President's health care law. The remaining savings come from changing the cost-sharing rules for various Medicare benefits.

The budget does not propose any meaningful reforms that would alter the long-term trajectory of Medicare spending, which the administration's own Health and Human Service Secretary has called "unsustainable."[13] Instead, the President's budget proposes to require the Independent Payment Advisory Board (IPAB), an unaccountable board of 15 unelected officials, to make additional reductions in Medicare spending in order to hold the program's growth to GDP + 0.5 percent. The President's budget also proposes to give IPAB "additional tools like the ability to consider value-based benefit design."

This appears to be a major policy change, because IPAB is currently statutorily prohibited from restricting benefits or changing cost-sharing arrangements for beneficiaries, and there is no way to interpret "value-based benefit design" that does not involve one or the other. To create value, one must either:

1. Give beneficiaries stronger incentives "to consider the cost of health services," as the President's budget explicitly proposes to do with regard to Medicare's coverage of home health services (see "Encourages Beneficiaries to Seek High-Value Services" on page 112 of the President's budget); or
2. Restrict seniors' benefits on the basis of a bureaucratic board's determination of "value."

Since the construction of IPAB is geared toward the latter, restricted benefits and denied care appear to be the most likely outcomes of the President's proposed policy change.

The President's health care law increased the number of people eligible for Medicaid by one-third, dramatically increasing the size of the program. As a result, Medicaid spending more than doubles over the decade, even after including his proposals to "reduce" Medicaid spending by roughly $56 billion over the next ten years. The majority of these savings comes in the form price controls. Two proposals make up for more than 75 percent of the total "savings":

1. Phasing down the Medicaid provider tax threshold; and
2. Using a single blended rate to determine the federal government's share of a state's Medicaid spending.

These proposals would further limit states' ability to address the unique needs of their own Medicaid beneficiaries. The administration continues to force states to abide by Washington-approved guidelines, rather than advancing policies that will reduce these burdens and provide states with the flexibility to pursue the innovative reforms that achieve real savings.

Social Security

Social Security currently faces a $6.5 trillion unfunded liability, and the latest CBO baseline shows Social Security in permanent cash deficits. Over the next ten years, it is expected to run deficits of $1.024 trillion. This will require Social Security to use a portion of its interest-related income from trust-fund surpluses occurring in prior years to continue paying benefits. Moreover, beginning in 2022, outgoing benefits will be greater than even the interest income, necessitating Social Security to begin redeeming trust-fund bonds. In 2036, the combined OASDI trust funds will go bankrupt, necessitating a 23 percent across-the-board benefit cut.

Additionally, the Social Security Disability Insurance (DI) Trust Fund is expected to go bankrupt in 2016. To address this looming bankruptcy, Congress must either pass legislation that would allow the DI Trust Fund to borrow from the Old Age and Survivors Insurance (OASI) Trust Fund or benefits will be reduced by approximately 25 percent. The President's budget provides for no major changes to the Social Security program. Proposed changes affecting Social Security in the budget include:

[13] House Budget Committee hearing on the Future of Medicare, July 12, 2011. http://budget.house.gov/News/DocumentSingle.aspx?DocumentID=251388

- Increased funding for program integrity activities. This would increase the amount of continuing disability reviews undertaken and its goal is to reduce fraud in the program. The Budget Control Act permits an upward cap adjustment of up to $623 million for this purpose.

- Reauthorizes SSA's demonstration authority for the DI program. This would include the administration's "Work Incentives Simplification Pilot," which would "eliminate work activity as a basis for the determination of disability cessation." That is, this would be a pilot program that said if you were able to work, you could still be considered disabled. It would maintain the current law substantial gainful activity (SGA) limits.

Income Security

Income security encompasses most means-tested entitlement programs, as well as unemployment insurance and civil service retirement programs, among others. When compared to the CBO baseline, the President's budget increases spending by $440 billion. The budget includes a mixture of spending increases and decreases. The major spending reductions include:

- Require federal employees to contribute additional amounts to their retirement plans. This is similar, though less aggressive, to what the House Budget Committee included in the FY2012 budget. This is estimated to save $27 billion over the next ten years. (Note: This is considered as revenue for scorekeeping purposes.)[14]

- Provide additional authority to the Pension Benefit Guaranty Corporation to increase premiums. The administration claims that this would save $16 billion over the next ten years, though CBO scored a similar proposal as only saving $8 billion last year.

The major spending increases include:

1. A $9.5 billion increase in child welfare programs, mostly by increasing child care subsidies.
2. Adding a new "universal dislocated workers program," to unemployment insurance at a cost of approximately $32.7 billion.
3. A $13.9 billion expansion of the earned income tax credit.

Commerce and Postal Service

Consolidation: Despite recent calls to grant President Obama fast-track authority to dissolve the Department of Commerce and reorganize the six major trade-related agencies into a one-stop shop for American businesses, the President's budget increases the Department of Commerce's budget by 5 percent to in FY2013 and provides no further detail on the how such a consolidation would take place.

National Wireless Initiative: The President's budget proposes to allow the FCC to encourage incumbent licensees who voluntarily return spectrum to be re-auctioned. An estimated $10 billion from the proceeds will go to build a nationwide network for first responders. The plan also calls for reallocation of federal agency and commercial spectrum using auctions and spectrum license user fees to generate $21 billion in deficit reduction over ten years. The House Energy and Commerce Committee has a somewhat similar measure, the Jumpstarting Opportunity with Broadband Spectrum (JOBS) Act. It auctions additional spectrum and saves $16.7 billion over ten years without imposing spectrum license user fees.[15]

[14] This provision was included as an offset in the recent payroll tax extension.
[15] This provision was included as an offset in the recent payroll tax extension.

Postal Reform: The budget calls for a number of reforms to address the insolvency of the U.S. Postal Service including moving from six-day to five-day-a-week mail delivery. It also calls for allowing the USPS to increase collaboration with state and local governments. It would also permit USPS during 2012 to raise postage rates by approximately 1.8 percent. The budget request also calls for returning to USPS $10.9 billion in payments they had previously made for their employees' pensions and deferring $14.1 billion of payments they are required to make for retiree health care costs. This would result in USPS paying $2.6 billion for retiree health prefunding over the next two years amortizing the remaining over 40 years.

Transportation

Reclassification and Reauthorization of Surface Transportation Spending: The budget proposes a new, six-year $476 billion surface transportation reauthorization bill. The proposal would make several programs that are currently discretionary into mandatory programs and place them into a new "Transportation Trust Fund" (TTF) including: the Office of the Secretary of Transportation, National Infrastructure Investments, Federal Railroad Administration spending (including Amtrak), National Highway Safety Administration (NHTSA) spending, and Federal Transit Administration (FTA). While the reclassification of these programs is accounted for with a downward adjustment in the discretionary caps, altogether, this policy represents a massive shift of spending from the capped, annually accountable discretionary spending process, to the auto-pilot, uncapped mandatory spending category. The budget proposes that $231 billion of this new $476 billion in spending to be offset by fictitious "savings" from the draw-downs in Iraq and Afghanistan.

More Stimulus: The President's budget requests an immediate mandatory supplemental appropriation of $50 billion in 2012 for transportation projects as proposed in the American Jobs Act. This is on top of the $48 billion in transportation stimulus spending provided by the ARRA.

High-Speed Rail: The budget requests $2.7 billion in 2013 and $47 billion over six years for rail spending – including high-speed rail – which will be reclassified from discretionary to mandatory and be funded through the new Transportation Trust Fund.

Education and Job Training

Student Loan Interest Rates: Partially fulfilling a 2006 campaign promise, Democrats passed the College Cost Reduction and Access Act of 2007, which temporarily lowered interest rates for Subsidized Stafford loans to 3.4 percent. Under current law, rates are set to go back up to 6.8 percent. The President's budget is proposing a one-year extension of the 3.4 percent interest rate, which CBO estimates will cost $5.85 billion.

Pell Grants: The College Cost Reduction and Access Act of 2007, the Higher Education Opportunity Act of 2008, the "stimulus" bill, and the Student Aid and Fiscal Responsibility Act of 2010 all made Pell grants more generous than the federal budget could afford, and these measures did not provide a plan to pay for these new promises to students. Program shortfalls have been filled with a series of one-time stimulus funds and mandatory funding patches. The President's budget continues this approach by proposing another $14 billion over ten years in mandatory appropriations to offset the projected funding shortfall of the Pell grant program. The President's budget only provides funding for the full Pell grant for two years.

Job Training: The administration's budget also layers on several new "back to work" programs including a community college initiative and a job-training fund. There are, however, already at least 49 separate existing job training programs that cost about $18 billion annually. The GAO has found that nearly all of these program overlap by providing similar services to similar populations, and only five of these programs have ever been evaluated for effectiveness.

Energy

The budget reflects very large increases in the energy function, rising from $6.7 billion in FY2011 to $9.2 billion in FY2012 (38 percent increase over 2011) to $15.7 billion in FY2013 (a 70 percent increase over 2012, and a 134 percent increase over 2011). This is consistent with President Obama's pledge to double down on energy investments, despite the Solyndra debacle that now threatens to cost taxpayers hundreds of millions.[16] Beyond 2013, spending drops off sharply and falls below 2011 levels by the end of the decade. This funding stream suggests a temporary energy stimulus with the promise of reductions later.

Conclusion

Without bold new leadership, the unsustainable trajectory of the national debt will trigger a sharp and sudden debt crisis that would threaten national security, hit seniors and low-income Americans the hardest, and leave all Americans with a diminished future. This looming crisis represents an enormous challenge, but it also represents a defining choice: whether to continue down the path of debt, doubt, and decline or put the nation back on the path to prosperity.

The President's budget offers a clear illustration of the former approach. By contrast, House Republicans offered a budget last year that would lift the debt and grow the economy. In response to the President's latest failure to lead, the House majority will continue to offer solutions that are equal to the nation's challenges.

[16] For more information, see "The Empty Promise of Green Jobs." House Budget Committee staff. September 22, 2011. http://budget.house.gov/News/DocumentSingle.aspx?DocumentID=261226