Chairman's Mark
2006 Budget

Prepared by
the U.S. Senate
BUDGET COMMITTEE
Chairman Judd Gregg
March 9, 2005

FY 06 OVERVIEW

U.S. Senate Budget Committee

The Chairman's Mark for the fiscal year 2006 Congressional Budget Resolution must deal with both short-term and long-term budget deficits, and begin a necessary shift in focus to long-term entitlement savings and reforms.

The Chairman's Mark meets the President's budget priorities of fully funding the war on terror, preventing economically damaging tax increases, maintaining fiscal discipline, putting in place strong enforcement and achieving modest but important savings in mandatory programs.

Despite these savings, it should be noted that the budget proposes spending record amounts in constant dollars - $2.6 trillion in FY06 and $13.8 trillion over five years.

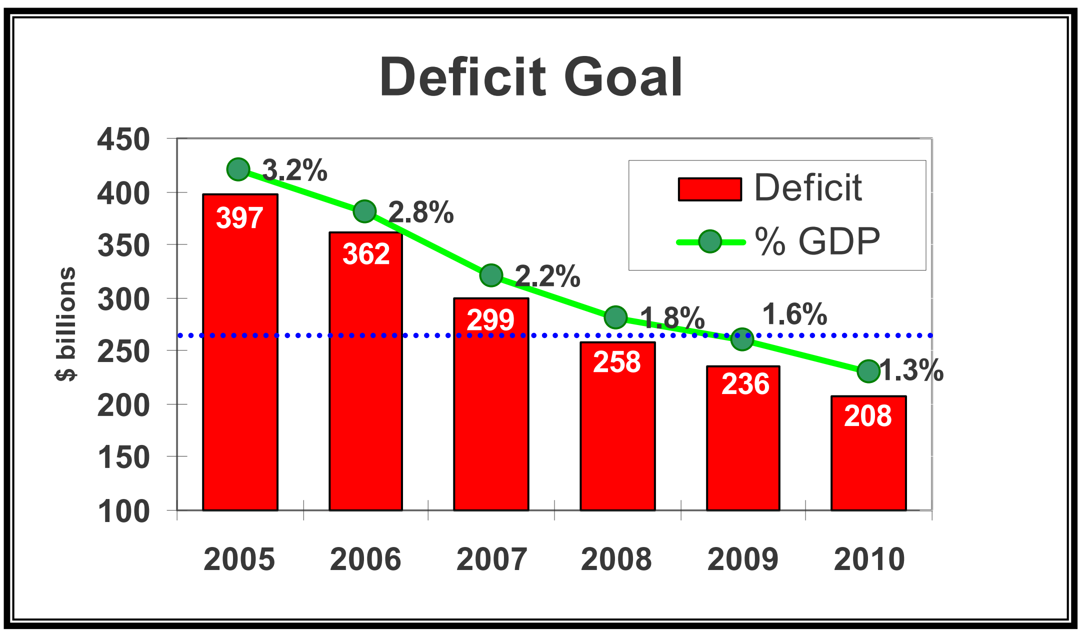
Short-Term Deficits

The Chairman's Mark meets the President's goal of halving the deficit from the level he projected a year ago for 2004, which was $521 billion, or 4.5 percent of GDP.

Reducing Budget Deficits

- The Chairman's Mark falls below the halfway mark in 2008 at $258 billion and falls throughout the five-year window to $208 billion in 2010. Stronger economic growth, or lower levels of spending, would result in even lower deficits.

- Relative to the size of the economy, deficits under the Chairman's Mark would fall to 2.2 percent of GDP in 2007 and 1.3 percent in 2010.



Slowing Discretionary Spending Growth

- The Chairman's Mark provides $843.4 billion in discretionary budget authority for 2006. This is consistent with the President's request, as scored by the Congressional Budget Office (CBO), with one adjustment for increased Pell Grant funding.

- Although the Chairman's Mark is required to assume specific levels of discretionary spending authority for each budget function, the Senate Appropriations Committee receives only an aggregate allocation from the Budget Resolution and is not required to follow (and has never followed) these assumptions when providing allocations to its subcommittees.

- The Chairman's Mark assumes full funding of the President's defense request, as scored by CBO, of $439 billion to meet the goals of supporting the global war on terrorism, restructuring U.S. forces and base structure, building capabilities for future threats and protecting the compensation and quality of life of U.S. military personnel.

- The Chairman's Mark provides a contingency fund of $50 billion for 2006 to fund ongoing military operations in Iraq and Afghanistan.

BA in Billions	***2005***	***2006***	***Growth***
Defense	*421.6*	*439.0*	*4.1%*
Non-defense	*404.4*	*404.5*	*--*
TOTAL	***826.0***	***843.4****	***2.1%***
Iraq/Afghanistan Supplementals	*81.9*	*50*	

NOTE: Numbers do not add due to rounding.

Long-Term Liabilities

Slowing the Growth of Mandatory Spending

- The Chairman's Mark instructs seven committees to produce net mandatory savings of $32 billion over five years. Mandatory spending would still grow from $1.5 trillion in 2005 to $2 trillion in 2010. A reconciliation package affecting spending programs was last enacted in 1997, when Congress passed savings more than five times the level proposed here.

- While the Chairman's Mark assumes specific policies to achieve these savings, the authorizing committees may report any legislation within their jurisdictions that achieves the required savings.

- Within the net reduction in mandatory spending, the Chairman's Mark assumes increases for higher education reauthorization, an energy bill and welfare re-authorization.

Other Budget Priorities

Enforcing Budget Discipline

- The Chairman's Mark sets discretionary spending caps for 2006, 2007 and 2008. The spending caps are set at levels consistent with the Mark's discretionary spending assumptions, and are enforced with a 60-vote point of order.

- The Mark maintains budget enforcement under existing mechanisms for non-defense emergency spending, advance appropriations and pay-as-you-go. It strengthens existing points of order against legislation creating unfunded mandates on state governments.

- The Mark establishes a new 60-vote budget point of order against legislation that would create new direct spending of more than $5 billion in any of the four 10-year periods between 2015 and 2055, as estimated by the Congressional Budget Office.

Preventing Tax Increases

- The Chairman's Mark includes tax policy assumptions focused on preventing economically damaging tax increases.

- Provisions of the Jobs and Growth Tax Relief Reconciliation Act of 2003 are set to expire after tax year 2008. Tax rates on capital gains income would jump from 15 to 20 percent and tax rates on dividend income would jump from 15 percent to as high as 35 percent. The Mark assumes these tax cuts are extended throughout the five-year budget window.

- Tax incentives for small business owners to invest and expand are set to expire after tax year 2007. The budget assumes these incentives continue throughout the five-year budget.

- The Chairman's Mark instructs the Finance Committee to produce a tax relief bill which reduces taxes by no more than $70.2 billion over the five-year budget window.

Other Highlights

- The Chairman's Mark reflects an increase in Pell Grant funding of $1.3 billion or 10.1 percent over 2005 by adding $417 million in new budget authority over the President's $843 billion discretionary request in 2006 ($2.1 billion over 5 years) in order to increase the maximum grant by $100 to $4,150 beginning in 2006. The number of recipients would <u>increase</u> by 138,000 over 2005, an increase of 2.6 percent.

- The Mark also includes a $5.5 billion reserve account to cover the new 5-year costs of initiatives in the reauthorization of the Higher Education Act (HEA) to be addressed by Congress this year and $4.3 billion in one-time budget authority in a reserve fund to eliminate the current Pell Grant shortfall.

- The Chairman's Mark provides a reserve fund of $2 billion over five years for enactment of a national energy policy, assumes $4.6 billion in associated tax incentives and assumes new receipts from opening the Arctic National Wildlife Refuge to drilling and exploration.

FISCAL YEAR 2006 BUDGET RESOLUTION
CHAIRMAN'S MARK
Total Spending and Revenues
(In billions of dollars)

Fiscal year			2005	2006	2007	2008	2009	2010	2006-10
Summary									
Spending	Total	BA	2,475.713	2,552.463	2,638.450	2,771.514	2,911.433	3,027.172	13,901.032
		OT	2,454.687	2,559.020	2,651.150	2,754.553	2,874.006	2,999.204	13,837.933
	On-Budget	BA	2,074.959	2,134.484	2,207.426	2,324.416	2,446.869	2,543.608	11,656.803
		OT	2,055.994	2,143.040	2,222.311	2,310.069	2,412.389	2,518.768	11,606.577
	Off-Budget	BA	400.754	417.979	431.024	447.098	464.564	483.564	2,244.229
		OT	398.693	415.980	428.839	444.484	461.617	480.436	2,231.356
Revenues	Total		2,057.383	2,197.500	2,352.179	2,496.307	2,638.462	2,791.548	12,475.996
	On-budget		1,483.908	1,592.723	1,714.387	1,824.619	1,932.613	2,051.205	9,115.547
	Off-budget		573.475	604.777	637.792	671.688	705.849	740.343	3,360.449
Deficit (-)	**Total**		**-397.304**	**-361.520**	**-298.971**	**-258.246**	**-235.544**	**-207.656**	**-1,361.937**
	On-budget		-572.086	-550.317	-507.924	-485.450	-479.776	-467.563	-2,491.030
	Off-budget		174.782	188.797	208.953	227.204	244.232	259.907	1,129.093
Debt Held by the Public (end of year)			4,688.918	5,060.681	5,372.906	5,644.888	5,892.763	6,111.689	
Debt Subject to Limit (end of year)			7,961.738	8,630.464	9,266.253	9,890.194	10,511.998	11,122.769	
By Function									
National Defense (050)		BA	498.761	491.562	465.260	483.730	503.763	513.904	2,458.219
		OT	496.928	496.117	479.984	479.730	489.146	505.872	2,450.849
International Affairs (150)		BA	34.707	33.295	36.580	37.131	37.171	36.862	181.039
		OT	32.425	35.737	34.629	33.994	33.842	33.433	171.635
General Science, Space, and Technology (250)		BA	24.413	24.735	25.294	25.796	26.102	26.413	128.340
		OT	23.594	23.894	24.672	25.095	25.472	25.808	124.941
Energy (270)		BA	2.564	3.247	2.859	2.923	2.534	2.232	13.795
		OT	0.794	2.127	1.698	1.035	1.132	1.022	7.014
Natural Resources and Environment (300)		BA	32.527	29.875	30.243	30.316	30.985	30.479	151.898
		OT	31.168	31.882	31.426	31.716	31.921	31.474	158.419
Agriculture (350)		BA	30.151	29.087	26.245	24.492	24.845	24.584	129.253
		OT	28.550	28.143	25.057	23.434	23.950	23.854	124.438
Commerce and Housing Credit (370)	Total	BA	13.004	5.620	4.666	6.215	6.613	10.170	33.284
		OT	7.502	0.446	-0.480	0.424	0.314	2.298	3.002
	On-budget	BA	16.804	10.220	9.866	9.815	10.413	14.270	54.584
		OT	11.302	5.046	4.720	4.024	4.114	6.398	24.302
	Off-budget	BA	-3.800	-4.600	-5.200	-3.600	-3.800	-4.100	-21.300
		OT	-3.800	-4.600	-5.200	-3.600	-3.800	-4.100	-21.300
Transportation (400)		BA	72.506	69.683	71.030	74.489	81.524	82.867	379.593
		OT	67.663	69.789	71.013	72.755	75.693	79.335	368.585
Community and Regional Development (450)		BA	23.007	13.039	13.118	13.272	13.410	13.430	66.269
		OT	20.756	18.294	16.697	14.715	13.473	13.125	76.304
Education, Training, Employment and Social		BA	94.026	91.850	89.904	90.585	90.737	90.329	453.405
Services (500)		OT	92.805	86.913	90.016	89.230	88.938	88.624	443.721
Health (550)		BA	257.498	260.542	273.232	292.063	313.844	332.926	1,472.607
		OT	252.799	260.904	272.660	290.672	310.304	331.961	1,466.501
Medicare (570)		BA	292.587	331.240	371.899	395.362	420.284	448.161	1,966.946
		OT	293.587	331.003	372.186	395.408	419.877	448.492	1,966.966
Income Security (600)		BA	339.651	347.395	352.633	365.775	374.946	384.137	1,824.886
		OT	347.850	353.429	358.674	370.107	377.951	386.269	1,846.430
Social Security (650)	Total	BA	522.557	546.809	572.203	600.483	633.133	668.691	3,021.319
		OT	520.496	544.810	570.018	597.869	630.186	665.563	3,008.446
	On-budget	BA	15.849	15.991	17.804	19.868	21.843	24.129	99.635
		OT	15.849	15.991	17.804	19.868	21.843	24.129	99.635
	Off-budget	BA	506.708	530.818	554.399	580.615	611.290	644.562	2,921.684
		OT	504.647	528.819	552.214	578.001	608.343	641.434	2,908.811
Veterans Benefits and Services (700)		BA	69.448	68.584	66.181	69.458	69.971	70.069	344.263
		OT	68.873	67.996	65.894	69.255	69.680	69.794	342.619
Administration of Justice (750)		BA	39.819	40.975	41.719	42.575	43.146	43.404	211.819
		OT	39.502	42.390	42.742	43.122	43.297	43.338	214.889
General Government (800)		BA	16.765	18.219	18.204	19.883	17.902	18.222	92.430
		OT	17.673	18.440	18.209	19.838	17.682	18.025	92.194
Net Interest (900)	Total	BA	176.980	213.807	253.468	280.213	297.507	311.787	1,356.782
		OT	176.980	213.807	253.468	280.213	297.507	311.787	1,356.782
	On-budget	BA	267.980	310.307	359.168	396.713	426.107	453.387	1,945.682
		OT	267.980	310.307	359.168	396.713	426.107	453.387	1,945.682
	Off-budget	BA	-91.000	-96.500	-105.700	-116.500	-128.600	-141.600	-588.900
		OT	-91.000	-96.500	-105.700	-116.500	-128.600	-141.600	-588.900
Allowances (920)		BA	--	--	--	--	--	--	--
		OT	--	--	--	--	--	--	--
Undistributed Offsetting Receipts (950)	Total	BA	-65.258	-67.101	-76.288	-83.247	-76.984	-81.495	-385.115
		OT	-65.258	-67.101	-77.413	-84.059	-76.359	-80.870	-385.802
	On-budget	BA	-54.104	-55.362	-63.813	-69.830	-62.658	-66.197	-317.860
		OT	-54.104	-55.362	-64.938	-70.642	-62.033	-65.572	-318.547
	Off-budget	BA	-11.154	-11.739	-12.475	-13.417	-14.326	-15.298	-67.255
		OT	-11.154	-11.739	-12.475	-13.417	-14.326	-15.298	-67.255

FISCAL YEAR 2006 BUDGET RESOLUTION
CHAIRMAN'S MARK
DEFICIT COMPARISONS
(In billions of dollars)

	2005	2006	2007	2008	2009	2010
President's budget (OMB)	-426.559	-390.067	-312.121	-250.820	-232.937	-207.313
% GDP	-3.5%	-3.0%	-2.3%	-1.8%	-1.5%	-1.3%
President's budget (CBO)	-394.117	-331.893	-278.190	-250.433	-246.449	-229.063
% GDP	-3.2%	-2.6%	-2.0%	-1.8%	-1.6%	-1.5%
Chairman's Mark	-397.304	-361.520	-298.971	-258.246	-235.544	-207.656
% GDP	-3.2%	-2.8%	-2.2%	-1.8%	-1.6%	-1.3%

FISCAL YEAR 2006 BUDGET RESOLUTION
CHAIRMAN'S MARK
SUMMARY SPENDING LEVELS
(In billions of dollars)

		2005	2006	2007	2008	2009	2010	2006-10
Discretionary *:								
Defense	BA	496.957	488.973	462.597	481.043	500.969	511.018	2,444.600
	OT	495.106	493.495	477.292	477.020	486.333	502.969	2,437.109
% change (BA)			-1.6%	-5.4%	4.0%	4.1%	2.0%	
Nondefense	BA	424.960	404.464	405.876	410.402	413.987	413.991	2,048.720
	OT	466.529	474.374	469.728	466.322	466.891	469.587	2,346.902
% change (BA)			-4.8%	0.3%	1.1%	0.9%	0.0%	
Subtotal	BA	921.917	893.437	868.473	891.445	914.956	925.009	4,493.320
	OT	961.635	967.869	947.020	943.342	953.224	972.556	4,784.011
% change (BA)			-3.1%	-2.8%	2.6%	2.6%	1.1%	
Mandatory outlays		1,316.072	1,377.344	1,450.662	1,530.998	1,623.275	1,714.861	7,697.140
Net interest outlays		176.980	213.807	253.468	280.213	297.507	311.787	1,356.782
Total outlays		2454.687	2559.020	2651.150	2754.553	2874.006	2999.204	13,837.933
% change			4.3%	3.6%	3.9%	4.3%	4.4%	
Revenues		2,057.383	2,197.500	2,352.179	2,496.307	2,638.462	2,791.548	12,475.996
% change			6.8%	7.0%	6.1%	5.7%	5.8%	
Chairman's Mark Unified Deficit		-397.304	-361.520	-298.971	-258.246	-235.544	-207.656	-1,361.937
% of GDP		-3.2%	-2.8%	-2.2%	-1.8%	-1.6%	-1.3%	
President's 2006 Unified Deficit (CBO reestimate)		-394.117	-331.893	-278.190	-250.433	-246.449	-229.063	-1,336.029
% of GDP		-3.2%	-2.6%	-2.0%	-1.8%	-1.6%	-1.5%	

NOTE: President's 2005 budget estimated the 2004 deficit to be $521 billion, 4.5% of GDP.

* In 2005, the President's proposed defense supplemental is reflected. As supplemental funding ramps down, total discretionary funding declines.

FISCAL YEAR 2006 BUDGET RESOLUTION
CHAIRMAN'S MARK
SUMMARY OF CHANGES FROM SBC BASELINE
(In billions of dollars)

	2005	2006	2007	2008	2009	2010	2006-10
SBC Baseline:							
Unified deficit	-364.571	-298.116	-268.098	-246.064	-218.897	-200.926	-1,232.101
On-budget	*-539.353*	*-486.913*	*-477.051*	*-473.268*	*-463.129*	*-460.833*	-2,361.194
Off-budget	*174.782*	*188.797*	*208.953*	*227.204*	*244.232*	*259.907*	1,129.093
Discretionary	32.121	53.119	26.451	2.521	-6.685	-7.547	67.859
Mandatory	0.149	-7.390	-5.730	-8.411	-7.551	-8.768	-37.850
Net interest	0.347	2.636	5.168	6.406	7.181	7.782	29.173
Tax cuts	-0.116	-15.039	-4.984	-11.666	-23.702	-15.263	-70.654
Total change	32.733	63.404	30.873	12.182	16.647	6.730	129.836
Resolution Total:							
Unified deficit	-397.304	-361.520	-298.971	-258.246	-235.544	-207.656	-1,361.937
On-budget	*-572.086*	*-550.317*	*-507.924*	*-485.450*	*-479.776*	*-467.563*	-2,491.030
Off-budget	*174.782*	*188.797*	*208.953*	*227.204*	*244.232*	*259.907*	1,129.093

FISCAL YEAR 2006 BUDGET RESOLUTION
CHAIRMAN'S MARK
DISCRETIONARY SPENDING SUMMARY
(Budget authority in billions of dollars)

	2005	2006	2007	2008	2009	2010
Defense (050)	496.957	488.973	462.597	481.043	500.969	511.018
Non-defense (including homeland security)	424.960	404.464	405.876	410.402	413.987	413.991
Total discretionary	921.917	893.437	868.473	891.445	914.956	925.009
Less Iraq/Afghanistan supplementals	81.881	50.000	-	-	-	-
Total discretionary excluding Iraq/Afghanistan supplementals *	840.036	843.437	868.473	891.445	914.956	925.009

* 2005 total includes emergency appropriations for non-defense related disasters.

Discretionary Caps		2006	2007	2008
Final caps after adjustments	BA	843.437	868.473	891.445
	OT	946.869		
Includes amount for $100 Pell grant increase	BA	(.417)	(.420)	(.420)
(non-add)	OT	(.100)	(.409)	(.419)
Reflects program integrity cap adjustments:				
Continuing Disability Reviews	BA	0.189		
	OT	0.189		
IRS Tax Enforcement	BA	0.446		
	OT	0.446		
Health Care Fraud and Abuse	BA	0.080		
Control Program	OT	0.080		
Unemployment Insurance	BA	0.040		
Improper Payments	OT	0.040		
Total Adjustments	BA	0.755		
	OT	0.755		
Initial caps before adjustments	BA	842.682	868.473	891.445
	OT	946.114		

Reconciliation by Senate Committee

	2006	2006-10
Agriculture, Nutrition and Forestry		
Total	**-0.171**	**-2.814**
Banking, Housing and Urban Affairs		
Total	**-0.030**	**-0.270**
Commerce, Science and Transportation		
Total	**-0.008**	**-2.576**
Energy and Natural Resources		
Total	**-0.033**	**-2.658**
Environment and Public Works		
Total	**-0.014**	**-0.112**
Finance		
Total	**-1.784**	**-15.036**
Health, Education, Labor and Pensions		
Total	**-2.204**	**-8.576**
Total Spending Reconciliation	**-4.244**	**-32.042**
Tax Relief Reconciliation	**-14.939**	**-70.154**

Reserve Funds by Senate Committee

	2006	2006-10
Energy Committee		
Energy Policy Legislation		
Budget Authority	0.100	2.000
Outlays	0.100	2.000
Health, Education, Labor and Pensions		
Higher ED Student Benefits/Costs		
Budget Authority	0.740	5.510
Outlays	0.676	5.006
Pell Shortfall Reserve BA ONLY		
Budget Authority	4.300	4.300
Outlays	--	--

Entitlements Taking Over Budget

Even as we reduce the short-term deficit, Congress must begin to look seriously at our government's long-term unfunded promises. Most of these pledges fall under one of three programs – Social Security, Medicare and Medicaid – and are largely dedicated to improving the quality of life of our retired citizens. These programs are on the verge of being overwhelmed by the largest generation in our nation's history, the Baby Boom Generation, which begins retiring in 2008.

Entitlements represented just over half of all federal spending last year. But in just 10 years ***they will balloon to two-thirds of the entire budget.*** (See Chart 1)

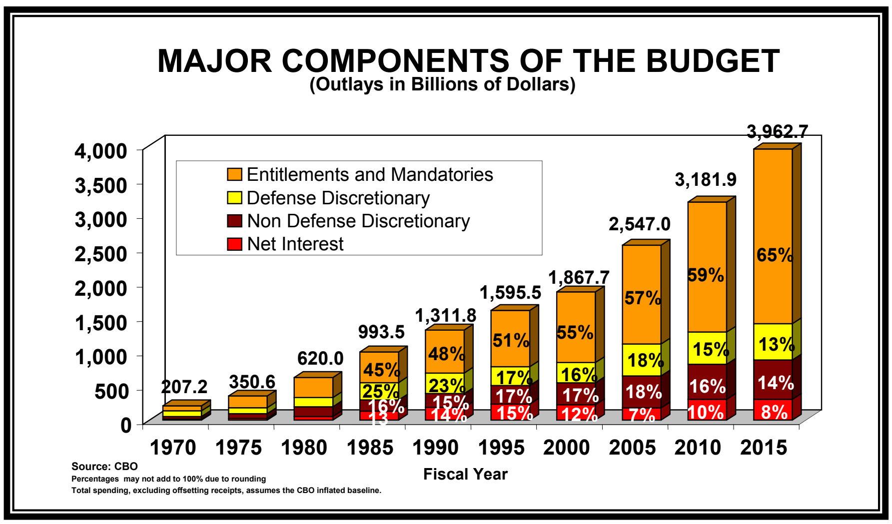


Chart 1

Over Promised & Under Funded

In an effort to shed more light on this looming problem, the Budget Committee conducted a series of hearings, "Long-Term Budget Challenges: Charting Stability for Our Children and Grandchildren." The testimony was eye-opening.

For instance, the Comptroller General of the Government Accountability Office estimates ***our nation's unfunded promises over the next 75 years are $44 trillion***. For comparison, all taxes raised by the federal government in its history totals only $38 trillion. The current net worth of all U.S. citizens is $47 trillion. (See Chart 2)

"The problem is too big to be solved by economic growth alone or by making modest changes to existing spending and tax policies. Rather, a fundamental reexamination of major spending and tax policies and priorities will be important to recapture our fiscal flexibility and update our programs and priorities to respond to emerging social, economic, and security changes," testified David Walker, Comptroller General of GAO.

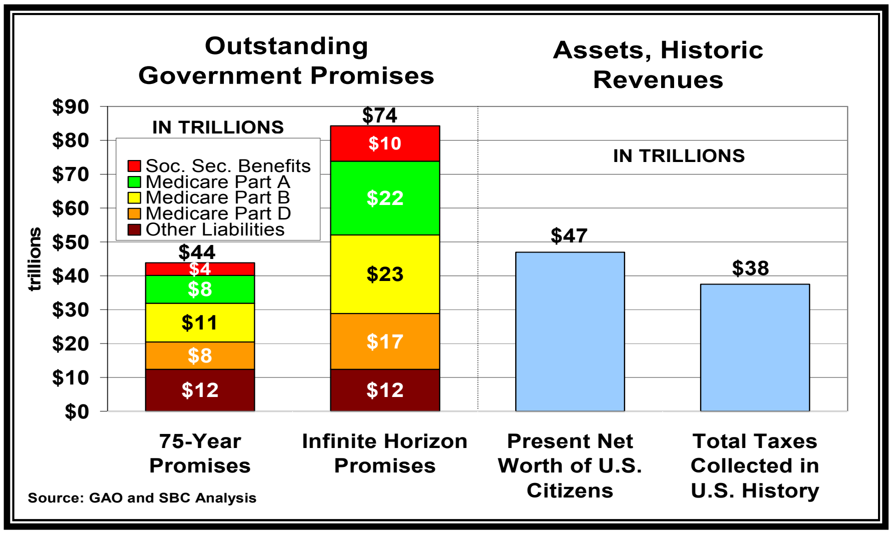


Chart 2

The Director of the Congressional Budget Office pointed out that average post-war government spending is 20 percent of gross domestic product. By 2050, Social Security, Medicare and Medicaid ALONE could require spending equivalent to 26 percent of GDP. (See Chart 3)

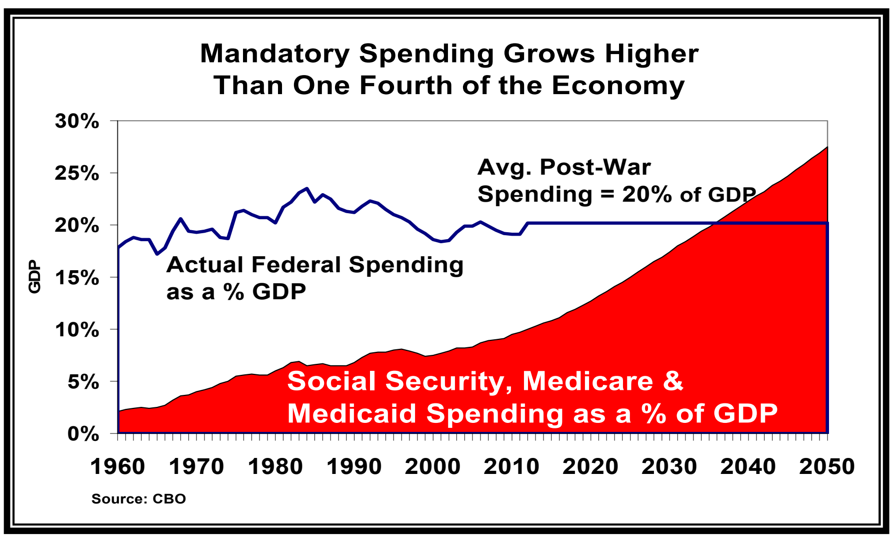


Chart 3

As CBO Director Douglas Holtz-Eakin points out, "I think ***our long-term budget situation is likely unsustainable.*** There is a long-term mismatch between the spending promised and the resources present to finance it, and the long-term spending promise could, in fact, be so large that one would not want to finance it as a matter of economic policy."

The pressure points at first glance seem to be far outside the current budget window. However, in reality, ***the problem actually begins in 2011*** – only one year beyond this year's five-year budget.

Other Programs Will Feel the Pinch

Since the mid-1980s, the annual payroll taxes collected for Social Security have outpaced benefits paid. This is what is known as the Social Security surplus. The annual surplus has grown larger every year. But that is about to change.

This year the federal government will collect $80 billion more in Social Security taxes than it will pay in benefits. The surplus is expected to expand to $88 billion in 2006 and grow larger each year until peaking at about $115 billion in 2011. At that point, the Social Security surplus begins to diminish for the first time, falling to $111 billion in 2012 and accelerating downward every year thereafter. (See Chart 4)

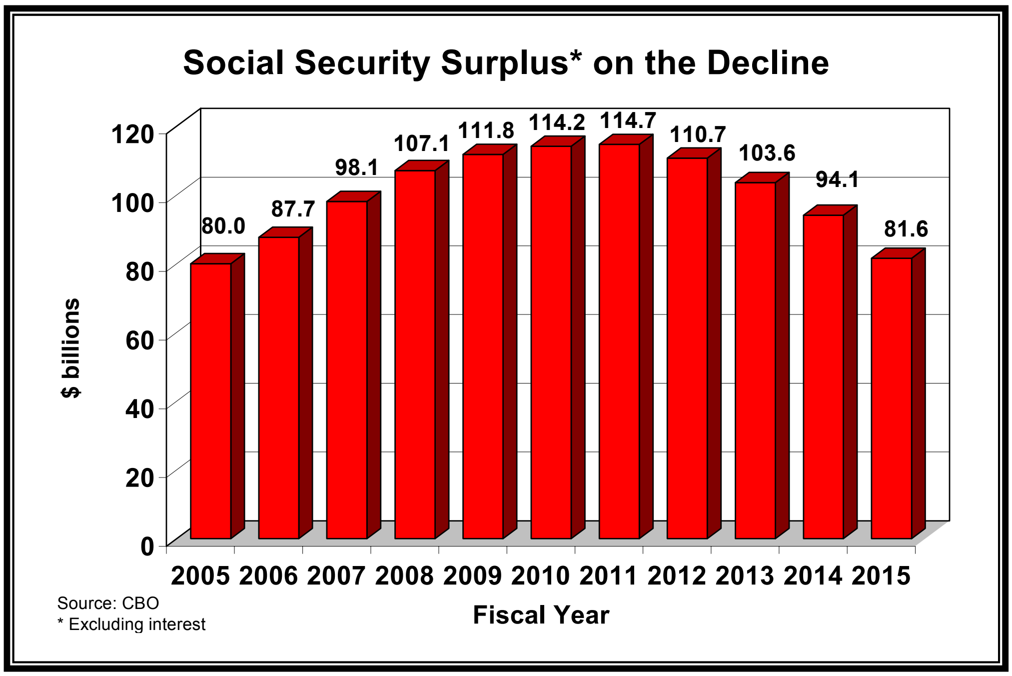


Chart 4

This is significant because ***every dollar collected in payroll taxes is spent*** on other things, including the surplus. So in 2011, when budget writers are looking at the fiscal year 2012 budget, they can count on less Social Security dollars to cover other spending, and the rest of the budget will begin to feel the pinch.

In the five-year period from 2011 to 2016, ***the shrinking Social Security surplus will gouge $33 billion out of the rest of the budget*** and with each coming year remove an accelerating amount as the Social Security surplus continues to contract.

This is a minute amount compared to the shortfalls that loom in the long-term, but it provides an understanding of the more immediate impact of the entitlement crisis.
The President's FY 2006 budget proposed about $51 billion in mandatory savings over five years, as scored by CBO.

The Chairman's Mark includes a reconciliation instruction of $32 billion in mandatory savings over five years. This amount is relatively small in a budget that assumes spending of $13.8 trillion over the same five-year time period.

The last budget year Congress achieved mandatory savings was FY97. That year, Congress passed and the President signed the Balanced Budget Act of 1997, which reconciled more than four times the amount envisioned in the current budget - $153 billion. At that time, the overall budget was significantly smaller than the Chairman's Mark. (See Chart 5)

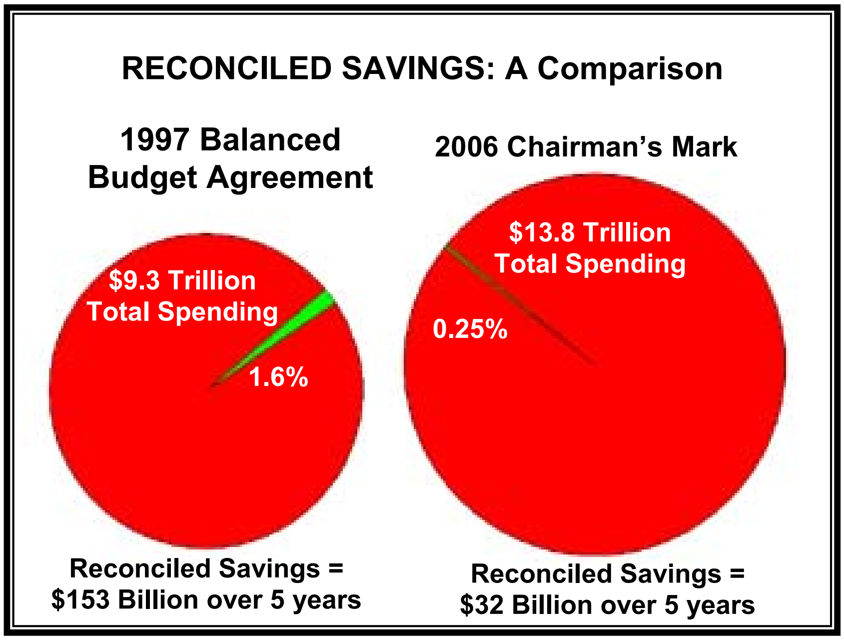


Chart 5

The modest mandatory savings in the Chairman's Mark is well within reason, and represents a small but important step in acknowledging the challenges that lay ahead.

FY 06 SPENDING & REVENUES

Spending Overview

Recently, spending by the federal government has consumed just under 20 percent of the total annual output of the U.S. economy (gross domestic product). Under CBO's baseline projections, the mix of spending between discretionary programs, which receive annual appropriations, and mandatory programs, whose spending is set by authorization law, is changing such that mandatory spending will consume an increasingly larger portion (65 percent) of federal resources by 2015.

In some previous congressional budget resolutions, much of the discussion has focused on assumptions about how discretionary spending could be displayed across all the budget functions in the name of federal programs that receive annual appropriations. This is curious since a budget resolution cannot affect the (sub-)allotment of discretionary resources across the numerous appropriation bills that fund those programs. The budget resolution simply allocates a top-line number to the Appropriations Committee. All other displays or arguments about how that number will translate into programmatic decisions in enacted appropriations law are rhetorical, but are not predictive or enforceable.

The President's budget has requested that total resources devoted to annual appropriations in 2006 be $843 billion. The Chairman's Mark simply allocates that level of budget authority to the Appropriations Committee in 2006. (For the next two years, the Chairman's Mark would set discretionary spending limits on budget authority reflecting the President's request for national defense and homeland security and modest inflation adjustment for the balance of discretionary spending.) There is little the budget resolution can do that could govern how the Appropriations Committee spends those resources. Though as in recent years, in this time of war and defending the homeland, one would expect that the President's request for appropriations in these areas will be funded accordingly. Nonetheless, the Chairman's Mark understands the Senate and ultimately the Congress will work its will in allocating resources program by program through the appropriations process.

On the mandatory side, the majority of federal spending is on autopilot and rarely undergoes annual review or evaluation. Under CBO's baseline projections, net programmatic mandatory spending, over which Congress could exercise direct control, will grow at an average annual rate of 5.8 percent over the next 10 years. The driver of this unsustainable growth rate is the cost of the federal health programs. The uncontrolled growth of these programs will increase the deficit in future years, adding to the component of mandatory spending that is controllable only indirectly – federal interest costs.

The Chairman's Mark seeks to begin a process of scrutinizing these trends in mandatory spending, correcting wasteful or abusive spending practices in these unexamined programs, and occasionally redirecting some inefficiently used resources to more productive purposes.

It has been some time since a budget resolution seriously examined the larger and faster growing mandatory portion of federal spending. Under the terms of the bipartisan budget agreement negotiated in 1997, Congress enacted a five-year reconciliation package that was estimated to shave about 1.6 percent of total projected federal outlays over the subsequent five years. In this Chairman's Mark, total projected baseline outlays over the next five years would begin to be reduced -- by 0.25 percent, assuming the reconciliation targets are met.

Most of the following discussion concentrates on the large areas of mandatory spending of particular interest in the Chairman's Mark.

Reconciliation

The Chairman's Mark directs seven committees to report by June 6, 2005 their recommendations to meet a reconciliation target totaling $32 billion over the 2005-2010 period as follows: (NOTE: Numbers may not add due to rounding)

Agriculture	$ 2.8 billion
Banking	$ 0.3 billion
Commerce	$ 2.6 billion
Energy	$ 2.7 billion
Environment & Public Works	$ 0.1 billion
Finance	$15.0 billion
Health, Education, Labor, and Pensions	$8.6 billion

Major Programmatic Areas

Agriculture

The Senate Agriculture, Nutrition and Forestry Committee would contribute to deficit reduction by reconciling $2.8 billion in savings over five years. This level of mandatory spending reduction affords the flexibility needed to achieve a reduction in the deficit while ensuring continued, adequate support for programs that assist farmers and ranchers, promoting conservation and reducing hunger.

Education and Pensions

The Chairman's Mark reflects an increase in Pell Grant funding of $1.3 billion (or 10.1 percent) over 2005 by adding $417 million in new budget authority ($100 million in outlays) to the President's discretionary request of $843 billion in budget authority. This amount would be sufficient to increase the maximum grant by $100 to $4,150 beginning in 2006. Compared to the last year of the Clinton Administration, Pell Grant spending in 2006 will have increased by $4.9 billion or 56 percent.

Given this level of funding, the number of Pell Grant recipients would increase by 138,000 over 2005, an increase of 2.6%. Compared to the last year of the Clinton Administration, the number of Pell Grant recipients in 2006 will be 1.2 million (or 28 percent) greater.

The Chairman's Mark assumes savings from reduced lender subsidies (some have described their receipts in excess of the statutorily guaranteed yield as "corporate welfare to banks"). A majority of these savings are returned to students in the form of program enhancements to expand access to college, and the remainder to taxpayers in the form of deficit reduction.

The Mark includes a $5.5 billion (in BA) reserve account to cover the new costs (over 5 years) of initiatives in the reauthorization of the Higher Education Act (HEA) to provide increased access to college for low- and middle-income students. It further assumes that the HEA reauthorization will include loan forgiveness up to $4,000 for Pell Grant recipients who complete a degree within 4 years and have student loan debt. The loans would be converted to the equivalent of grant aid by being paid off during the grace period once the borrower documents completion of a degree. A student receiving the full amount of forgiveness would receive the equivalent of $5,150 in grant aid each year of school. Finally, the Mark includes provisions to retire the existing $4.3 billion shortfall in budget authority for Pell Grant funding and to prevent future shortfalls in the program.

Regarding pensions, the Pension Benefit Guaranty Corporation (PBGC) insures the defined-benefit pensions of roughly 44 million workers who participate in those plans against plan failures; roughly 1 million individuals now receive or are owed benefits under plans that have been taken over by the PBGC. In just a few short years, the PBGC fund has gone from a surplus to a deficit, as current and projected likely liabilities now exceed assets by more than $20 billion.

The President's budget assumes a significant increase in fixed insurance premiums, under-funding charges, and new risk-based premiums on all participating employers at a cost of over $18 billion over five years as part of a comprehensive strategy to strengthen the retirement security of America's workers, estimate plan liability more accurately and retire the fund's deficit.

Based on the PBGC's calculations, single-employer defined-benefit plans are under funded by more than $450 billion. Restoring the health of these plans will be a significant expense to employers at a cost on top of and several times greater than the proposed fee increase.

The Chairman's Mark recognizes the challenges faced by employers in maintaining and strengthening both fully-funded and under funded defined-benefit plans. Accordingly, the level of premium increases and other savings assumed in the Mark has been significantly reduced from levels originally proposed to $0.8 billion in 2006 and $5.3 billion over 5 years.

The Federal Employment Compensation Act (FECA) provides for the payment of workers' compensation to Federal civilian employees, but has not been substantially updated since 1974. The Chairman's Mark assumes the adoption of the President's proposal to improve program administration, streamline claim processing, require upfront waiting periods, and authorize the Department of Labor (DOL) to recapture compensation costs from third parties. These changes are expected to generate significant government-wide savings—in the hundreds of millions of dollars—that will ultimately be reflected in baseline updates; at this time $51 million is assumed over the next five years.

Energy and Natural Resources
The Chairman's Mark includes a reserve fund for energy policy legislation, which totals $0.1 billion in budget authority for 2006 and $2.0 billion in budget authority for the 2006-2010 period.

The Chairman's Mark also assumes a $2.5 billion increase in receipts as a result of opening the Arctic National Wildlife Refuge (ANWR) to oil exploration and development; however, the budget resolution cannot dictate the contents of legislation reported by any committee. Additionally, the Chairman's Mark includes a reserve fund stipulating that if legislation is enacted that opens ANWR to drilling, $1.05 billion of the associated receipts will be devoted to appropriations for the Land and Water Conservation Programs, the Forest Legacy Program, and the Coastal and Estuarine Land Protection Program ($350 million per year in 2008, 2009, and 2010).

Health

The Committee notes that there is great potential for savings in the Medicaid program due to waste and abuse in the system. The Chairman's Mark includes reconciliation instructions for the Finance Committee to report legislation that reduces mandatory spending by $15.036 billion over 2006-2010. As the Finance Committee considers this legislation, the Budget Committee points out that at least 34 states are estimated to be receiving up to $6 billion a year in federal Medicaid dollars inappropriately. The reconciliation legislation may include policies achieving savings in Medicaid or other programs.

The Chairman's Mark assumes spending of $189.5 billion in Medicaid in 2006 and $1.1 trillion over 2006-2010.

The Chairman's Mark assumes the President's proposal to reauthorize Transitional Medical Assistance through Fiscal Year 2006.

The Chairman's Mark includes spending of $330.5 billion in Medicare in 2006 and $1.96 trillion over 2006-10. The Chairman's Mark includes the President's proposal to reauthorize the QI-1 program for 1 year to pay Part B premiums for low income beneficiaries.

Veterans
The Chairman's Mark omits the President's proposal to create a new $250 enrollment fee and to increase prescription drug co-pays for priority-level 7 and 8 veterans. Since fiscal year 2002, President Bush's first budget submission, the total veteran's budget has grown by $16 billion or 30.8 percent and discretionary spending has increased by $7.8 billion or 30.8 percent.

Other Spending Issues

Defense

Also of interest is the President's request for defense programs, including $419.5 billion in discretionary budget authority for the Department of Defense, an increase of $18.3 billion or 4.6% over the 2005 level. Discretionary budget authority for the entire defense function (including the Department of Energy Atomic Defense Activities and Other Defense Activities in addition to DOD) totals $439.0 billion. Over the period of the Mark, the average annual increase in defense would be 4.1%. This level of defense funding would achieve four goals: support the Global War on Terrorism, restructure U.S. forces and reposition their global basing structure, build joint capabilities for future threats, and protect the compensation and quality of life of U.S. military personnel. Further, the Mark recognizes that our troops will need additional support in the budget year and therefore sets aside $50 billion to fund Iraq and Afghanistan costs in 2006.

Reserve Funds

As discussed above, the Chairman's Mark establishes several reserve funds that would allocate spending for specific legislation relating to an energy policy bill, a higher education reauthorization bill, and a bill that eliminates the Pell Grant shortfall in budget authority.

The mark also includes several deficit-neutral reserve funds for the following purposes:

- A bill that creates an Asbestos Injury Trust Fund that compensates injured victims of asbestos-related disease, as long as the bill is deficit neutral for 50 years.

- A bill that improves health care quality through the adoption of health information technology and performance-based payments that are based on accepted clinical performance measures.

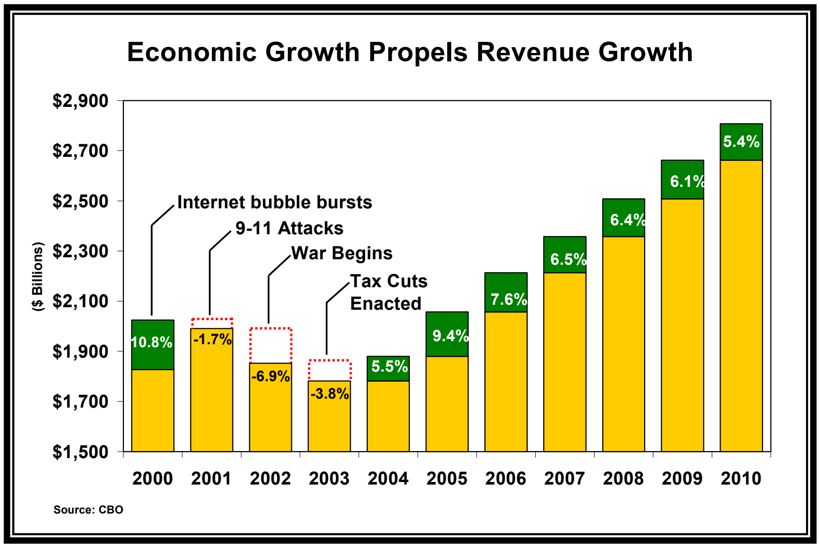
- Establishes a deficit neutral reserve fund for committees of jurisdiction (HELP and Finance) to pass legislation that addresses health care costs, reduces the number of uninsured, or improves access to care.

Adjustment for surface transportation

The Chairman's Mark provides a mechanism to increase allocations of contract authority and outlays for the relevant committees that report legislation relating to the reauthorization of and appropriation for surface transportation programs, provided that the reauthorization (by virtue of a title reported by the Committee on Finance) makes available new net resources for the highway trust fund that offset the resulting outlays--without increasing the deficit.

Revenues Overview

Federal revenue collections are on the rise again, following three years of actual decline. The terrorist attacks of September 11, the bursting of the stock market bubble, corporate scandals and an economic recession resulted in declines in tax collections in 2001, 2002 and 2003. Revenues rose 5.5 percent in 2004 and are projected to rise 9.4 percent in 2005. In 2005, the federal government will finally be back to the level of revenues collected in 2000, prior to the terrorist attacks.



The Chairman's Mark assumes that tax rates are not increased (as they would be under current law). The Mark assumes a modest reduction in revenues, relative to the baseline, that balances the need for fiscal responsibility with the need to continue modest tax rates necessary for economic growth and job creation.

The Chairman's Mark assumes on-budget revenues are reduced by $70.2 billion over five years. The Mark instructs the Senate Finance Committee to report reconciliation legislation (by September 7, 2005) to reduce revenues by no more than $14.9 billion in 2006 and $70.2 billion over the 2006-2010 period.

The CBO baseline projects that the federal government will collect <u>$12.5 trillion</u> over the next five years in tax receipts. The tax relief assumed in the Mark is 0.6 percent of total expected revenues.

The tax relief assumed in the Mark is sufficient to accommodate extensions through 2010 of current capital gains and dividend tax rates, and existing provisions for small business expensing. The Mark can accommodate extensions of other provisions that will expire within the budget window, such as the deduction for state and local sales taxes, the savers credit and the deduction for qualified tuition expenses. The Mark also accommodates energy tax credits and a permanent extension of the death tax repeal.

ENFORCEMENT

U.S. Senate Budget Committee

The Chairman's Mark maintains and strengthens budget enforcement tools.

Discretionary spending caps
The Mark sets caps in 2006 for budget authority at $843.4 billion and outlays at $946.9 billion. The Mark sets caps on budget authority at $868 billion in 2007 and $891 billion in 2008. During the appropriations process, a bill that would push total discretionary spending beyond the cap amount would be subject to a 60-vote point of order.

Creates a new tool to check long-term spending
The Mark establishes a new 60-vote point of order against legislation that would cost more than $5 billion in any of the four 10-year periods between 2015 and 2055.

Strengthens enforcement against unfunded mandates
Under current budget law, a 50-vote point of order lies against legislation that creates unfunded mandates on states if there is no cost estimate or if the bill costs more than $66 million beginning in the year enacted or any of the following four years. The Mark strengthens these rules by requiring 60 votes to waive the point of order.

Maintains other enforcement
The Mark extends through 2010 other existing enforcement, including a 60-vote point of order against legislation exceeding committee allocations (302(a)s), a $23.4 billion cap on advance appropriations, limits on the use of "emergency" designation to avoid budget rules, and a 60-vote point of order against Appropriations subcommittee bills that exceed the subcommittee's allocations (302(b)s).

Maintains existing Pay-as-you-go provision
The Mark leaves unchanged the Pay-as-you-go rule in the FY04 Budget Resolution, the last budget agreed to by the full Congress. The rule establishes a 60-vote point of order against legislation that would increase the deficit beyond the level assumed in the FY06 Budget Resolution in FY06, the five-year period from FY06-2010 or the 5-year period from FY11-2016.

Recent Developments in US Employment

Over the last three years, growth in labor productivity has averaged 4.4 percent per year, 2.1 percentage points faster than average growth since World War II. Faster productivity growth explains how businesses have been able to generate additional output without hiring substantial numbers of new workers relative to past business cycle recoveries. During the most recent recession and subsequent recovery, many firms were reluctant to hire new workers and instead focused on increasing efficiency, thereby propelling productivity higher. Firms have now probably squeezed as much productivity as they can from their existing workforce and capital stock and will need to expand in the future to address additional increases in demand.

Consistent with this view, the Bureau of Labor Statistics announced on March 4, 2005 that the economy created 262,000 new jobs in February, registering its 21st consecutive month of job creation. Over this period, 3.0 million new jobs were created. A record 132.8 million people are now working.

The unemployment rate also declined 0.2 percentage points in February to 5.4 percent from a year ago. The unemployment rate is now significantly below its peaks in the 1980s and 1990s. In contrast, unemployment in Europe's largest economy, Germany, increased to 12.6 percent of the labor force, which is more than double the rate here in the United States.

The Economic Forecast

The Administration and Blue Chip both forecast ***real GDP*** growth exceeding 3.5 percent this year, which would register above its 20-year historical average of 3.2 percent. CBO forecasts that the economy will grow at a slightly faster rate of 3.8 percent. All three forecasts expect growth to return to a more moderate trend in the medium term.

CBO, OMB and Blue Chip all forecast that the ***unemployment rate*** declines by at least 0.2 percentage points this year. CBO is the most optimistic, forecasting an unemployment rate of 5.2 percent, before converging with OMB in 2006. Over the medium-term, the Administration and Blue Chip's projection of unemployment settles at its ten-year average of 5.1 percent. CBO's projection remains slightly higher on average over the 2005-2010 period.

Inflation is anticipated to decelerate through 2005 and 2006. Both OMB and CBO estimate inflation declines 0.3 percentage points to 2.4 percent this year. The private sector consensus forecasts a slightly slower deceleration to 2.5 percent. In the medium term, the

Administration and Blue Chip's projection of inflation reverts back to its 10-year average of 2.4 percent after 2007. CBO forecasts that inflation falls an additional 0.5 percentage points in 2006 before rising to its steady state rate of growth of 2.2 percent. CBO's forecast lags both OMB and Blue Chip's by at least 0.2 percentage points from 2007 through 2010.

All three forecasts indicate a moderate increase in short- and long-term ***interest rates*** consistent with a growing economy. CBO and Blue Chip both forecast that short-term interest rates double this year as the Federal Reserve continues to withdraw the liquidity it injected into the economy during the recession. Blue Chip's projection continues to rise and peaks in 2008 before leveling off at 4.2 percent. CBO's forecast of short-term interest rates jumps by more that 0.5 percentage point and settles at 4.6 percent through 2010. The Administration's forecast of short-term rates lags behind both CBO and the private sector by just 0.1 percentage point this year and at least 0.3 percentage points through 2008 before catching up with the Blue Chip in 2010.

Since the Federal Reserve initiated its tightening cycle last June, the rate on 10-year Treasury notes has edged lower, suggesting financial markets remain confident inflation remains in check. And although all three projections show the rate on 10-year notes increasing gradually, none rise above their level in 2000.

Income shares are a less publicized portion of the forecast but are important because they underpin revenue projections. Income shares depict the breakdown of national income between wages and salaries, benefits, corporate profits, proprietors' income, rental income, and net interest. Income shares are expressed as a percentage of GDP.

If all types of national income were taxed at the same rate, the division between income categories would make little budgetary difference. This is not the case. Wages and salaries and corporate profits are taxed at a higher effective tax rate -- as such, the more they grow relative to the other income categories, the higher the projected revenue stream. Corporate profits and wages and salaries are termed the "highly-taxed shares."

Both CBO and OMB expect the highly-taxed shares to rise to their peak in 2005 before steadily declining throughout the remainder of the projection. Corporate profits as a share of GDP rises as a result of the expiration of bonus depreciation, which permitted firms to deduct a larger-than-usual percentage of their capital expense from their profits in 2004. Steadily declining corporate profits as a share of GDP largely accounts for the overall downward trend in taxable income after 2005 under both forecasts. The drop also reflects the contribution that firms are expected to make to their defined benefit pension plans.

Wages and salaries rise slightly to 45.8 percent of GDP by 2008 in both forecasts, then rises steadily through 2010, albeit not enough to offset the decline in the corporate profit share. Interestingly, CBO and OMB project nontaxable shares of income in the form of employer-sponsored health care and pension contributions to rise through 2010.

Despite economic assumptions in line with CBO and the private sector, OMB estimates a 2005 ***baseline budget deficit*** of $390 billion versus CBO's estimate of $368 billion. Only $4 billion of the discrepancy is attributable to different assumptions about how much tax revenue will be generated by a given level of economic output. However, economic and technical changes to mandatory programs accounts for $19 billion of the difference. In the aggregate, these two deficit forecasts are nearly identical.

Sensitivity to Economic Changes

There is uncertainty in any economic forecast. According to an analysis by OMB, a reduction in the real GDP growth rate of 1.0 percentage point would increase the 2005-2010 deficits by $529 billion. CBO conducted the same "rule of thumb" analysis and found similar results. However, it is important to note that the uncertainty could work in the other direction as well.

The Forecasting Record

According to a Congressional Research Service (CRS) report entitled *Economic Forecasts and the Budget* (which examined same-year forecasts by CBO, OMB and Blue Chip), CRS could find no sign of statistically significant bias in any of the three forecasts. CRS reviewed the forecasts of GDP, inflation, unemployment, and 91-day Treasury bills between 1982 and 2004. All had a slight tendency to **understate** economic growth, although OMB's average error was slightly less than CBO or the private sector consensus. All three forecasts **overstated** inflation. Of the four economic indicators studied, CRS found that CBO, OMB and Blue Chip were virtually tied in forecasting the unemployment rate. And all three tended to **overstate** increases in short-term interest rates, although OMB had the smallest average error.

ECONOMIC PROJECTIONS COMPARISON

	2004	2005	2006	2007	2008	2009	2010
Administration*	11,731	12,392	13,083	13,797	14,537	15,306	16,112
CBO*	11,730	12,396	13,059	13,766	14,486	15,210	15,940
Blue Chip*	11,728	12,398	13,066	13,763	14,496	15,210	15,940
% Change (Year to Year):							
Real GDP Growth							
Administration	4.4	3.6	3.5	3.3	3.2	3.1	3.1
CBO	4.4	3.8	3.7	3.7	3.4	3.1	2.9
Blue Chip	4.4	3.6	3.4	3.2	3.2	3.1	3.1
GDP Price Index							
Administration	2.1	1.9	2.0	2.1	2.1	2.1	2.1
CBO	2.1	1.8	1.5	1.7	1.8	1.8	1.8
Blue Chip	2.1	2.0	2.0	2.1	2.1	2.1	2.1
Consumer Price Index							
Administration	2.7	2.4	2.3	2.4	2.4	2.4	2.4
CBO	2.7	2.4	1.9	2.1	2.2	2.2	2.2
Blue Chip	2.7	2.5	2.3	2.4	2.4	2.4	2.4
Annual Rate:							
Unemployment							
Administration	5.5	5.3	5.2	5.1	5.1	5.1	5.1
CBO	5.5	5.2	5.2	5.2	5.2	5.2	5.2
Blue Chip	5.5	5.3	5.2	5.1	5.1	5.1	5.1
Three-Month T-Bill							
Administration	1.4	2.7	3.5	3.8	4.0	4.1	4.2
CBO	1.4	2.8	4.0	4.6	4.6	4.6	4.6
Blue Chip	1.4	3.0	3.8	4.1	4.3	4.2	4.2
Ten-Year T-Note							
Administration	4.3	4.6	5.2	5.4	5.5	5.6	5.7
CBO	4.3	4.8	5.4	5.5	5.5	5.5	5.5
Blue Chip	4.3	4.7	5.3	5.6	5.6	5.6	5.6
Share of GDP:							
Corporate Profits							
Administration	8.5	10.5	9.8	9.2	8.7	8.3	8.0
CBO	8.5	10.7	9.4	9.0	8.8	8.7	8.5
Wage and Salaries							
Administration	45.6	45.6	45.8	46.0	46.2	46.4	46.6
CBO	45.6	45.7	45.8	45.8	45.9	45.9	45.9

*President's FY 2006 Budget; CBO's "Economic and Budget Outlook: Fiscal Years 2006 - 2015"; Blue Chip January 2005 Economic Indicators for 2005 and 2006, Blue Chip October 2004 Economic Indicators for 2007-2010