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FISCAL OVERVIEW OF THE PRESIDENT'S BUDGET

6 February 2006

SUMMARY

Total Federal spending would be held to an average of 3.6-percent growth per year over the next 5 years, under the President's budget submission for fiscal year 2007 – a rate that would gradually reduce the government's share of economic resources. To maintain this level of restraint, the President calls for a hard freeze in non-defense, non-Homeland Security discretionary spending, and substantial savings in mandatory spending (spending not subject to annual appropriations).

The President also, once again, calls for making permanent the tax relief provisions enacted in 2001 and 2003, and providing modest new tax reductions. Even with these policies, the administration projects total revenue to grow an average of 5.8 percent per year. Revenue would increase from $2.3 trillion in 2006 to $3.0 trillion in 2011, or from 17.5 percent of gross domestic product [GDP] to 17.9 percent.

The President's Budget: Total Spending, Revenue, and Deficits
(dollars in billions)

							Annual Percent Change	
	2006	2007	2008	2009	2010	2011	2006-07	5-year annl.avg
Outlays	2,709	2,770	2,814	2,922	3,061	3,240	2.3	3.6
Revenue	2,285	2,416	2,590	2,714	2,878	3,035	5.7	5.8
Deficit (-)	-423	-354	-223	-208	-183	-205	-16.3	-13.5
Deficit as % of GDP	-3.2	-2.6	-1.5	-1.4	-1.1	-1.2		

Source: Office of Management and Budget.

The combination of these fiscal policies – with revenue outgrowing spending – yields the budget deficit reduction the President has stated: cutting the deficit in half by 2009. For fiscal year 2006, the current fiscal year, the budget submission projects a deficit of $423 billion (including the supplemental appropriations measure for military operations in Iraq and Afghanistan and hurricane recovery that will be submitted to Congress later this month). Although a record in nominal terms, this deficit ranks 12th as a share of the economy over the past 25 years, at 3.2 percent of GDP. Under the President's policies, the Office of Management and Budget [OMB] estimates the deficit will decline to $354 billion, or 2.6 percent of GDP, in fiscal year 2007, and then will continue falling to $183 billion, or 1.1 percent of GDP in 2010.

As discussed in more detail below, the lower growth rate of spending is the net result of legislative actions the administration proposes. Net savings would be achieved in discretionary spending, and would be achieved in mandatory spending as well if the transition costs for Social Security private accounts are excluded. Revenue also would be reduced below baseline levels.

DISCRETIONARY SPENDING PROPOSALS

The President requests new discretionary budget authority [BA] totaling $870.7 billion for fiscal year 2007, an increase of 3.2 percent over the $843.3 billion enacted for fiscal year 2006 non-emergency appropriations. In addition, the President anticipates requests for emergency supplemental appropriations of $88 billion in fiscal year 2006 and $52.3 billion in 2007. Of the $88 billion anticipated for 2006, $70 billion is for ongoing operations in Iraq and Afghanistan, and $18 billion is for hurricane-recovery activities. The $52.3 billion for 2007 emergency funding consists of $50 billion for the war and $2.3 billion for avian flu preparedness. These new requests add to the $58.4 billion in emergency supplemental funds already enacted in fiscal year 2006 for Iraq and hurricane recovery.

The President's Budget: Discretionary Totals
(dollars in billions)

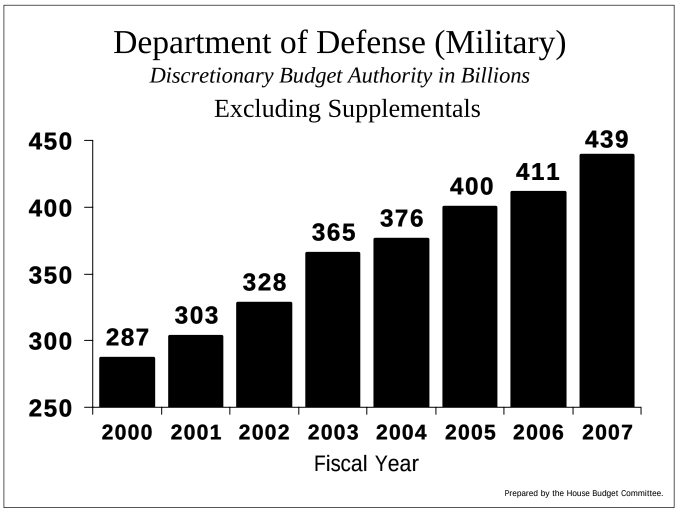
	2006	2007	Annual Dollar Change	Annual Percent Change
Regular Budget Authority:				
Department of Defense - Military	410.8	439.3	28.5	6.9
Homeland Security (nondefense)	32.1	33.1	1.0	3.3
Other Nonsecurity	400.4	398.3	-2.2	-0.5
Subtotal - Regular Appropriations	843.3	870.7	27.3	3.2
Emergency Supplemental Budget Authority:				
Enacted FY2006 Supplemental	58.4			
Anticipated FY2006 and FY2007 Supplemental	88.0	52.3		
Subtotal - Supplemental and Emergency	146.0	52.3		
Total	989.3	923.0	-66.3	-6.7

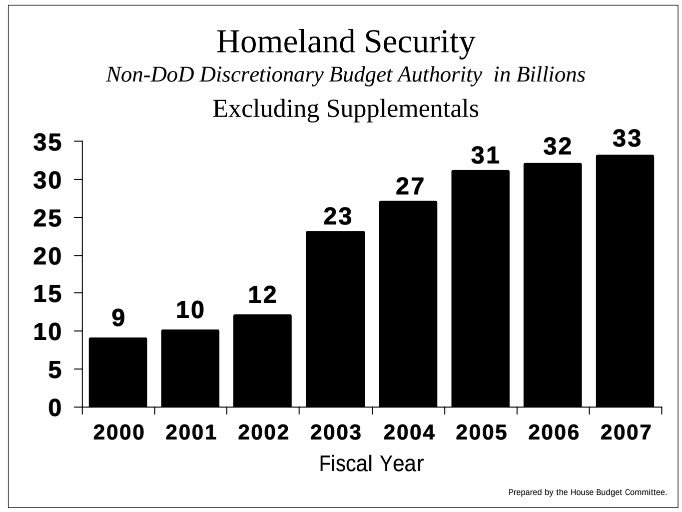
Source: Office of Management and Budget
Figures may not add due to rounding.

Over the 5 years covered by the budget submission, the administration assumes an annual average growth rate of 2.2 percent in total discretionary BA. This growth rate is below the projected rate of consumer price inflation, and a sharp reduction from the 5.5-percent average rate of increase in the preceding 5-year period. The budget continues a significant shift in discretionary policies that began with last year's budget submission. As shown in the table below, the 2007 request provides 6.9-percent growth for Defense appropriations, and 3.3-percent growth for Homeland Security. At the same time, it proposes a 0.5-percent reduction in "nonsecurity" (nondefense, non-Homeland Security) spending. The 2007 budget marks the second year the administration has proposed a year-over-year decline in nonsecurity spending.

A further look at the individual categories follows below:

- **Defense Appropriations:** The administration recommends $439.3 billion in BA for fiscal year 2007 for the military functions of the Department of Defense, an increase of 6.9 percent over the $410.8 billion provided in fiscal year 2006. This continues the growth trend in recent years for this category, though at a slower pace than the 6.3-percent average annual growth of 2001-06 (see chart). For the 5-year budget period, the budget assumes a 4.1-percent rate of increase, resulting in Defense appropriations of $502 billion in 2011.





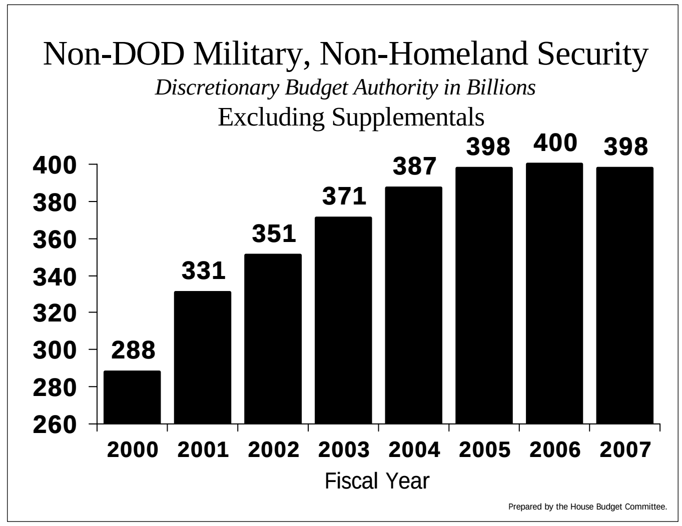
- **Homeland Security Appropriations:** The administration recommends $33.1 billion in fiscal year 2007 for nondefense Homeland Security – an increase of nearly $1.0 billion, or 3.3 percent, over the $32.1 billion in fiscal year 2006. In fiscal year 2000, spending in this category was approximately $9 billion; following September 11th, however, it has grown significantly – at an average annual rate of 23.5 percent over the past 6 years (see chart). The President's requested increase for fiscal year 2007 reduces this rate of growth, but still exceeds inflation. For fiscal years 2007 through 2011, the budget assumes a 4.6-percent rate of increase, resulting in nondefense Homeland Security appropriations of $40 billion in 2011.

  The Department of Homeland Security [DHS] would increase from $30.5 billion in 2006 to $30.9 billion in 2007 under the President's request. This $0.4-billion increase is a 1.3-percent year-over-year increase for this agency. (It should be noted that some funding provided to DHS is not counted in the Homeland Security category of spending.)

- **All Other Appropriations:** The administration recommends $398.3 billion in fiscal year 2007 for appropriated spending other than defense and Homeland Security – a decrease of $2.2 billion, or 0.5 percent, below the level for fiscal year 2006 (see chart). For years after 2007, the budget assumes a hard freeze on this portion of discretionary spending at the 2007 level, including the effects of savings from mandatory spending programs to offset appropriations.

The practice of achieving discretionary reductions through mandatory savings itself warrants a further description, as follows.

The chart shows a slight increase in non-security spending between 2005 and 2006, even though appropriations bills for 2006 reduced this spending by 0.7 percent. The difference arises because the appropriations bills included savings from mandatory programs, which are not recorded as discretionary in the following year's budget. The administration's proposed reduction includes $4.6 billion in mandatory savings. Next year's budget would exclude those savings, and show an increase in nonsecurity spending of 0.6 percent. This is a significant reduction from the growth rate of the previous 5-year period, 3.9 percent (see chart).



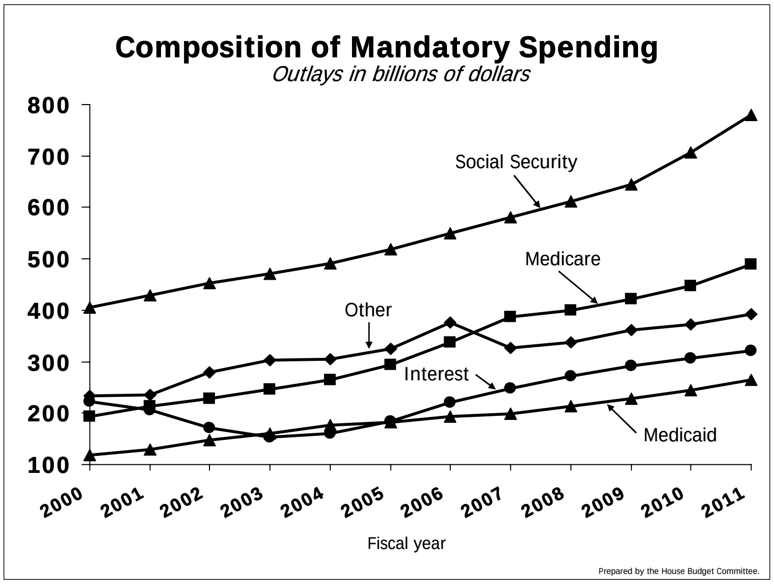
To summarize, under the administration request, defense military appropriations as a share of total discretionary appropriations would increase from 50.5 percent of the total in 2007 to 53.3 percent of the total in 2011. Nondefense Homeland Security appropriations would increase from 3.8 percent of the total in 2007 to 4.3 percent of the total in 2011. Nonsecurity appropriations would decrease from 45.7 percent of the total in 2006 to 42.3 percent of the total in 2011.

Without this consistent spending discipline, deficits increase significantly. If growth in nonsecurity were to continue, from the 2006 level, at the rate of consumer price inflation, it would add $148.7 billion to discretionary BA spending over the next 5 years – $50.4 billion in 2011 alone.

MANDATORY SPENDING PROPOSALS

The administration proposes an overall increase in mandatory spending of $5.1 billion for fiscal year 2006, a reduction of $1.7 billion for fiscal year 2007, and a net increase of $21.2 billion for fiscal years 2007-11, which grows to $551.1 billion for 2007-16 (see table below). The proposals would accelerate the growth in mandatory spending from the annual average of 5.3 percent projected in the baseline to 5.7 percent over the next 5 years. That increase in the growth rate is due to the transition costs of administration's Social Security personal accounts proposal, which increases spending by $81.6 billion for fiscal years 2010-11. Excluding personal accounts, the growth rate decreases to 5.1 percent.

Overall, the President's budget request in mandatory spending shows a number of small savings across all Federal Government agencies. Those savings are not enough, however, to offset the large spending increase arising from the transition cost of the President's Social Security personal accounts initiative.



Spending increases total $5.1 billion for fiscal year 2006, $3.2 billion for fiscal year 2007, $99.1 billion for fiscal years 2007-11, and $752.9 billion for fiscal years 2007-16. Those increases are partially offset by savings of $5.0 billion for fiscal year 2007, $77.9 billion over 5 years, and $201.8 billion over 10 years. With these changes, mandatory spending would reach $1,456.5 billion in fiscal year 2006, somewhat higher than the OMB baseline, and $1,492.9 billion in fiscal year 2007, slightly lower than the OMB baseline level. Compared to the baseline spending level of $1,451.4 billion for fiscal year 2006, the proposed spending for 2007 is a 2.9-percent increase. Mandatory spending continues to increase each following year at an average annual rate of 6.6 percent, reaching $1,924.2 billion in fiscal year 2011.

Several administration proposals are repeated from the fiscal year 2006 request. These include: opening a portion of Arctic National Wildlife Refuge [ANWR] for oil and gas exploration; increasing Pension Benefit Guaranty Corporation [PBGC] premiums; reforming child tax and earned income tax credits; reducing agriculture commodity programs; imposing Environmental Protection Agency [EPA] fees; recovering unemployment insurance benefit overpayments; and imposing spectrum license fees. Others are modified versions of last year's initiatives, such as the health tax credit and Medicaid/State Children's health Insurance Program [SCHIP] savings and program expansions. In addition to those recurring proposals, the administration proposes savings from Medicare and the Federal Employee Health Benefits Program.

Finally, the budget includes Social Security personal accounts; details of this initiative were not complete when the budget was submitted last year.

The President's Budget: Mandatory Spending **(excluding Net Interest)**
(dollars in billions)

	2006	2007	2008	2009	2010	2011	2007-11	2007-16
OMB Baseline	1,451.4	1,494.6	1,575.1	1,667.6	1,761.6	1,882.8	8,381.7	N.A.
Proposed Increases (including fees)	5.1	3.2	2.9	3.6	27.9	61.5	99.1	752.9
Proposed Savings (including fees)	0	−5.0	−17.2	−16.8	−18.9	−20.0	−77.9	−201.8
Net	5.1	−1.7	−14.3	−13.2	9.0	41.4	21.2	551.1
President's Budget	1,456.5	1,492.9	1,560.8	1,654.4	1,770.6	1,924.2	8,402.9	N.A.

Source: Office of Management and Budget.

Spending Increases

The largest increase is for the Social Security personal accounts. This proposal would allow workers to invest some of their payroll taxes into personal retirement accounts for their use upon retirement, which increases spending. When those workers begin to draw on their personal accounts as a supplement to Social Security, spending will be commensurately reduced, so this increase in spending occurs only during the transition to a retirement system in which personal accounts are a basic component of retirement security. This cost begins in fiscal year 2010, and outlays associated with the provision increase spending by $81.6 billion for fiscal years 2010-11, and $712.1 billion for fiscal years 2010-16.

The President's Budget: Mandatory Spending Increases
(dollars in millions)

	2006	2007	2008	2009	2010	2011	2007-11	2007-16
Soc. Security Personal Accounts	0.0	0.0	0.0	0.0	24,182.5	57,428.7	81,611.2	712,144.3
Further Hurricane Response	5,050.0	560.0	0.0	0.0	0.0	0.0	0.0	560.0
Medicaid/SCHIP	0.0	1,227.0	686.0	539.0	425.0	601.0	3,478.0	6,773.0
Grants to States for Chronically Ill	0.0	250.0	375.0	492.5	506.3	522.5	2,146.3	5,000.0
TANF	0.0	40.0	149.0	425.0	473.0	488.0	1,575.0	4,070.0
Other Spending Increases	75.0	1,159.0	1,696.0	2,149.0	2,278.0	2,424.0	9,706.0	24,331.0
Total Spending Increases	5,115.0	3,236.0	2,906.0	3,605.5	27,864.7	61,464.2	99,076.4	752,878.3

Source: Office of Management and Budget.

The second largest increase over the 6-year budget horizon is for emergency spending for further hurricane recovery, totaling $5.1 billion for fiscal year 2006 and $560 million for fiscal year 2007. The next largest increase is for Medicaid/SCHIP programs: those costs are estimated to be $1.2 billion for fiscal year 2007, $3.5 billion over 5 years, and $6.8 billion over 10 years. Grants to States for the chronically ill would increase spending by $250 million for fiscal year 2007, $2.1 billion over 5 years, and $5.0 billion over 10 years. Spending for Temporary Assistance for

Needy Families [TANF] would increase by $40 million for fiscal year 2007, $1.6 billion over 5 years, and $4.1 billion over 10 years.

Spending Decreases

Medicare savings provide the largest 5-year savings. The President would reduce spending by $2.5 billion for fiscal year 2007, $35.9 billion for fiscal years 2007-11, and $105.0 billion for 2007-16. The next largest savings proposal is PBGC reform. It decreases spending by $16.7 billion over 5 years and $37.1 billion over 10 years. Changes in Medicaid/SCHIP programs are estimated to reduce spending by $723 million for fiscal year 2007, $4.9 billion over 5 years, and $11.9 billion over 10 years. Changes in commodity programs would reduce spending by $1.1 billion for fiscal year 2007, $5.0 billion over 5 years, and $8.9 billion over 10 years. ANWR would increase offsetting receipts by $4.0 billion over both the 5-year and 10-year period. Unemployment insurance integrity legislation, aimed at recovering benefit overpayments, would reduce spending by $2.2 billion over 5 years and $5.0 billion over 10 years.

The President's Budget: Mandatory Spending Decreases
(dollars in billions)

	2007	2008	2009	2010	2011	2007-11	2007-16
Medicare	−2,452.0	−5,485.0	−7,948.4	−9,343.0	−10,662.9	−35,891.3	−105,015.9
Reform PBGC	0.0	−4,195.0	−4,181.0	−4,164.0	−4,140.0	−16,680.0	−37,056.0
Medicaid/SCHIP	−723.0	−876.0	−1,062.0	−1,116.0	−1,168.0	−4,945.0	−11,859.0
Commodity Program Changes	−1,081.4	−1,078.8	−945.5	−965.4	−916.7	−4,987.7	−8,933.5
ANWR	0.0	−3,502.0	−2.0	−503.0	−3.0	−4,010.0	−4,025.0
UI Integrity	0.0	−540.0	−639.0	−494.0	−511.0	−2,184.0	−4,989.0
Other Spending Decreases	−723.0	−1,569.0	−2,012.0	−2,277.0	−2,638.0	−9,219.0	−29,912.0
Total Spending Decreases	−4,979.4	−17,245.8	−16,789.9	−18,862.4	−20,039.6	−77,917.0	−201,790.4

Source: Office of Management and Budget.

REVENUE PROPOSALS

The budget proposes a number of tax and trade policy changes that affect revenue (and, to a lesser extent, outlays as well). Taking these policies into account, the administration projects that receipts will increase from $2.285 trillion (17.5 percent of GDP) in fiscal year 2006 to $3.035 trillion (17.9 percent of GDP) in fiscal year 2011.

The administration's tax and trade policies would reduce revenue by $15.9 billion in fiscal year 2006, by $29 billion in fiscal year 2007, and by $289.1 billion over 5 years; refundable tax credits would increase outlays by $532 million in 2007 and by $5.2 billion over 5 years. The administration would partially offset these budget effects, however, by enacting a number of revenue-raising provisions that would increase revenue by $407 million in fiscal year 2007 and by $9 billion over 5 years. The net result from the administration's tax and trade proposals would be a deficit increase of $15.9 billion in 2006, $28.6 billion in 2007, and $280.1 billion over 5 years.

A portion of this deficit increase is the result of the extension of the 2001 and 2003 tax relief, which the Administration assumes as part of its baseline, rather than being reflected as a new tax reduction. When viewed this way, the administration's tax and trade policies reduce revenue by $16 billion in 2006, $28.1 billion in 2007, and only $101.5 billion over 5 years.

The President's Budget: Receipts Proposals - Summary
(dollars in billions)

	2006	2007	2008	2009	2010	2011	Total 2007-11
Make Permanent 2001, 2003 Tax Relief[a]	0.083	-0.531	-7.736	-37.023	-13.596	-119.714	-178.600
Incentives and Tax Relief	---	-2.909	-3.927	-8.411	-13.052	-19.292	-47.591
Extend Expiring Provisions	-15.960	-25.583	-6.384	-7.289	-8.047	-8.705	-56.008
Other	0.003	-0.015	1.318	-1.315	-3.722	-3.133	-6.867
Close Loopholes and Rev. Offsets	---	0.407	1.841	2.331	2.234	2.191	9.004
Total Receipts Effect (with permanence of 2001, 2003 provisions as additional relief)	**-15.874**	**-28.631**	**-14.888**	**-51.707**	**-36.183**	**-148.653**	**-280.062**
Total Receipts Effect (with permanence of 2001, 2003 provisions assumed in baseline)	**-15.975**	**-28.100**	**-7.152**	**-14.684**	**-22.587**	**-28.939**	**-101.462**
Total Outlay Effect[b]	---	0.532	0.871	1.243	1.375	1.193	5.214

Source: Office of Management and Budget.
[a] The administration assumes the permanence of these provisions within the baseline, not as new legislation. This table represents the revenue effects both ways.
[b] Reflects refundable portion of certain tax credit provisions, under the assumption that the permanence of 2001 and 2003 provisions are not in the baseline.

The overall set of revenue proposals, summarized in the table above, can be categorized as follows:

- **Making Permanent the 2001 and 2003 Tax Legislation:** A top administration priority is making permanent the broad tax relief provided in 2001 – generally scheduled to expire in 2010 – and most of the growth package enacted in 2003 a top legislative priority. The revenue loss (compared with levels that would result if all the provisions expired as scheduled) resulting from making these provisions permanent is $531 million in fiscal year 2007 and $178.6 billion over 5 years. As noted, this amount is assumed in the budget's baseline, rather than being reflected as a new tax reduction.

- **New Tax Relief Initiatives:** The administration also has proposed enactment of new tax initiatives in several areas, including personal savings, small business, health care, charitable giving, economic development, benefits for families, and pensions. These provisions reduce revenues by $2.9 billion in 2007, and $47.6 billion over 5 years.

- **Extending Expiring Tax Provisions:** The administration would make permanent or extend temporarily a number of tax provisions that expired during the current year or are scheduled to expire during the budget year. These include a 1-year extension of current alternative minimum tax [AMT] policies for individuals, and the research and experimentation tax credit. The extenders proposed by the administration cost $16 billion in 2006, $25.6 billion in 2007, and $56 billion between 2006 and 2011.

- **Revenue Offsets:** The administration has included a number of revenue offsets in its budget, intended not only to raise revenue but also to close loopholes, curtail tax avoidance, and improve tax administration. As noted, these provisions increase revenues by $407 million in 2007, and $9 billion over 5 years.

- **Trade Policies:** The administration also has an ambitious agenda for expanding American exporters' access to foreign markets. To this end, the administration hopes to conclude negotiations during 2006 on several free trade agreements, and to extend, through the end of Calendar year 2011, the Generalized System of Preferences. These agreements would reduce revenues by $648 million in 2007, and $6.1 billion over 5 years.