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The Obama Budget: A Summary and Analysis

As promised, the President's budget outline suggests it will result in declining deficits from $1.8 trillion this year (12.3% of GDP) to $1.2 trillion in 2010 (8% of GDP) to 3.5% of GDP in 2012 and settling around 3% of GDP every year thereafter through 2019.

But the debt held by the public doubles from $5.8 trillion (41% of GDP) in 2008 to $11.5 trillion (66% of GDP) in 2013. By 2019, debt will have tripled from the 2008 level to $15.4 trillion (67% of GDP).

President's 2010 Budget Proposal - Deficits and Debt

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Deficits												
$ billions	459	1,752	1,171	912	581	533	570	583	637	636	634	712
% of GDP	3.2%	12.3%	8.0%	5.9%	3.5%	3.0%	3.1%	3.0%	3.2%	3.0%	2.9%	3.1%
Debt held by public-% GDP	41%	59%	65%	67%	67%	66%	66%	66%	66%	66%	67%	67%

How much would the deficit go down if we did nothing? Using the only common baseline there is (the one used for Paygo), which assumes no change to current law (i.e., assumes the tax cuts will expire), the deficit would decline from $1,428 billion in 2009 to $156 billion in 2013. In other words, ***if we do nothing***, the deficit will decline by 90 percent over the next four years. The President's budget prefers to do something – increase spending – which would result in the President's preferred deficit of $533 billion in 2013.

How would President's budget fare under Paygo? The Administration proposes to return to the statutory paygo system (enforced by sequesters) that was in place from 1991-2002. **If that form of paygo were still in place today, the President's budget would violate paygo to the tune of $3.5 trillion over the next 10 years.** Of course, under that paygo system, the universe of programs that could be sequestered would be far smaller than the $3.5 trillion in sequesters that would be required (and Congress and the President would never allow that to happen anyway), so the statutory paygo system would be spectacularly irrelevant.

Assessment: The budget's promise of lower deficits in the future depends heavily on the following several factors, some of which are sketchy.

Revenues. The President proposes to extend the 2001 and 2003 tax relief provisions that expire at the end of 2010 without offsetting the revenue loss associated with the extensions. He also proposes a permanent fix for the Alternative Minimum Tax without offsets. He incorporates a deficit increase of $3.3 trillion over ten years into his baseline to account for this.

From this starting point, the President proposes to increase tax rates in 2011 for both regular income and capital gains/dividend income for those earning above $200,000 (single) and $250,000 (joint). He also proposes to reinstate the personal exemption phase-out and limitation on itemized deductions for upper-income taxpayers, and to limit the tax rate at which itemized deductions reduce tax liability for all taxpayers.

In total, the President's tax rate increases and limitations on deductions would increase revenues by $955 billion over ten years. President Obama's budget also includes $646 billion in new tax collections from instituting a cap-and-trade regime for greenhouse gases. All other tax policies in the budget, on net, reduce taxes by $183 billion. The total net tax increase in the President's budget, relative to the OMB baseline, is $1.4 trillion over 10 years.

War Costs. The President claims that reducing the number of troops in Iraq will reduce the deficit by $1.6 trillion over 10 years. But the baseline never assumes that much will be spent on wars over the next 10 years, so the savings are illusory.

Eliminating Programs. The budget outline assumes virtually no savings from eliminating programs. In the speech to Congress, the President stated that he had already found $2 trillion in such savings over 10 years, and was only now about to begin the process of going through the budget line by line for additional savings (some of which won't be identified until the President submits the usual, full-blown detailed budget documents in April, and some of which won't be announced until subsequent years).

It turns out that the claim of $2 trillion in savings results from the combination of increasing taxes by $1.0 trillion (by not extending a subset of the tax cuts and initiating new tax increases) and "lowering" war spending from a baseline that does not exist. In reality, nondefense discretionary spending and mandatory spending would increase over 10 years, contributing nothing to deficit reduction.

Bottom line: If the deficit comes in as promised in 2013, at 3% of GDP, we will be right back where we started last year in 2008, when the deficit was about 3% of GDP. If we follow the President's budget, in 2013 we will still be facing the same daunting long-term crisis, but in the intervening four years, we will have incurred additional deficits of $4.4 trillion and will have increased the debt from $5.8 trillion to $11.5 trillion. We will have missed the chance to reform programs to deal with the **real** problem, which is the long-term unsustainability of health and retirement benefits people think they will be getting in the future that won't be affordable.

Let's look at parts of the budget more closely to see what the President is proposing to do in key areas.

Revenues

President Obama said his tax policy proposals would reduce taxes for 95% of American taxpayers. That statement is hard to reconcile with the fact that his budget raises taxes, on net, by $1.4 trillion over ten years.

Tax Relief – The President proposes to make permanent four provisions enacted as temporary provisions in the stimulus bill just a few weeks ago. His proposals to make permanent the Making Work Pay tax credit, the American Opportunity tax credit, expansion of the EITC, and the expansion of the refundability of the child tax credit together increase the deficit by $715 billion over ten years ($320 billion additional spending, $395 billion tax relief).

The President proposes to expand the saver's credit and automatic enrollment in retirement savings plans at a cost of $55 billion over ten years ($7 billion additional spending, $48 billion tax relief). The budget includes a proposal (that would start in 2014) to eliminate capital gains taxation on small business ($7 billion tax relief) and a proposal to make the research and experimentation tax credit permanent ($74 billion tax relief). The President proposes to extend several expiring provisions for one year at a cost of $21 billion over ten years.

The gross amount of tax relief in the President's budget (not counting the spending associated with refundable credits) is about $545 billion over ten years.

Tax Increases - the President proposes to increase individual tax rates in 2011 for both regular income and capital gains/dividend income for those earning above $200,000 (single) and $250,000 (joint). He also proposes to reinstate the personal exemption phaseout and limitation on itemized deductions for upper-income taxpayers, and to limit the tax rate at which itemized deductions reduce tax liability for all taxpayers. In total, the President's tax rate increases and limitations on deductions increase revenues by $955 billion over ten years. President Obama's budget also includes $646 billion in new tax collections from instituting a cap-and-trade regime for greenhouse gases.

President Obama's budget includes about $21 billion in additional revenues from efforts to reduce the tax gap, and $210 billion in higher taxes from implementation of international tax enforcement.

The President proposes repeal of nine oil and gas production tax incentives, raising taxes by $31 billion over ten years. He also proposes to reinstate Superfund taxes ($17 billion), tax carried interest as ordinary income ($24 billion), codify the Economic Substance Doctrine ($5 billion) and repeal last-in-first-out accounting ($61 billion).

The gross amount of tax increases in the President's budget is about $1.97 trillion over ten years.

PRESIDENT'S TAX PROPOSALS IN 2010 BUDGET

($ Billions)

	2010	10-yrs 2010-19
Tax relief included in adjusted baseline:		
Extend EGTRRA and JGTRRA provisions, index AMT to inflation, include revenue effect of HR 1 (stimulus) a/ b/	*-143*	*-3,252*
Tax relief proposals:		
Make HR 1 temporary provisions permanent b/	--	-395
Expand saver's credit and retirement savings incentives b/	--	-48
Permanent R&E tax credit	-3	-74
Eliminate capital gains taxes on small businesses	--	-7
Extend other expiring provisions for one year b/	-10	-21
Subtotal, tax relief proposals	**-13**	**-545**
Tax increase proposals:		
Raise marginal rates to 36 and 39.6 percent for taxpayers earning over $200K (single) and $250K (joint)	--	339
Reinstate pers exemption phaseout and limitation on itemized deductions over $200K (single) and $250K (joint)	--	180
Raise cap gains/dividends tax rate to 20% for taxpayers earning over $200K (single) and $250K (joint)	1	118
Further limit itemized deductions c/	--	318
Cap-and-trade permit auction proceeds	--	646
Implement international enforcement and other reforms	--	210
Repeal last-in-first-out accounting	--	61
Tax carried interest as ordinary income	--	24
Repeal 9 oil and gas production incentives	--	31
Reduce the tax gap	1	21
Reinstate Superfund taxes	--	17
Codify Economic Substance Doctrine	0	5
Subtotal, tax increase proposals	**2**	**1,970**
Total, net tax proposals	**-11**	**1,425**
President's Budget Revenues	**2,381**	**35,250**
% of GDP	16.2%	18.7%

a/ In continuing the 2001 and 2003 tax cuts, the estate tax is maintained at its 2009 parameters (45% tax rate on estates over $3.5 million).

b/ Proposals affect outlays; only the receipt effects are shown here.

c/ Tax increase included in Health Reform Reserve Fund.

Spending-Mandatory

Health. The President's budget would add $340 billion in costs on top of the Medicare and Medicaid baselines to reflect an increase in physician reimbursements (compared to current law). By changing the baseline, the budget suggests these increases should occur without offsets. In addition, the budget includes a $634 billion "reserve fund" to partially fund health care reform, paid for by policies to reduce Medicare and Medicaid spending by $316 billion along with a $318 billion increase in taxes.

Social Security. The President proposes no programmatic reform to the way Social Security benefits are currently structured.

Financial Markets Crisis. The President's outline includes $247 billion in outlays in 2009 that reflect the cost associated with the $700 billion in financial assistance authority enacted for the Troubled Asset Relief Program (TARP). [Note that OMB has conformed to the CBO methodology of showing the TARP costs on an accrual, not cash, basis.] In addition, the outline includes a placeholder of an additional $250 billion in outlays (and deficit increase) in 2009 for "potential additional financial stabilization efforts," consistent with the President's suggestion that another rescue package of $750 billion will be needed, roughly the same size as the initial TARP program ($700 billion).

New Mandatory Education Programs. The budget proposes to shift the Pell Grant program from a discretionary to a mandatory program while also increasing and then indexing (at CPI plus 1%) the maximum award, thereby increasing mandatory spending by $117 billion over 10 years. This proposal comes on the heels of the just enacted stimulus bill that provided over $17 billion in Pell Grant funding. Congress is also about to approve another $17 billion for Pell Grants in the 2009 Omnibus appropriation bill. The maximum Pell Grant award for the 2008-09 award year is $4,731. For the 2009-10 award year, the stimulus bill and Omnibus will result in the maximum award of $5,350. The President's budget would increase that to a $5,550 maximum award in the 2010-2011 school year. The Administration is also proposing a new College Access and Completion Fund with a ten- year cost of $2.5 billion.

Unemployment Insurance. The President's budget proposes to change the Extended Unemployment Insurance Benefits Trigger. This reform represents a major entitlement expansion and would increase the deficit by $21 billion over the 2010-2019 period, based on the Administration's forecast of unemployment. The President's modification would reduce the current threshold for states to trigger-on Extended Benefits, thereby avoiding future confrontations with Congress regarding multi-billion dollar emergency extensions of unemployment benefits. (Note: since the beginning of the current recession, Congress has enacted emergency extensions of unemployment benefits three times).

Mandatory Savings. On net, there aren't any. Rather, the President proposes to increase total mandatory spending by $357 billion over the next 10 years.

Spending-Discretionary

Proposed Discretionary Spending in FY 2010
(compared to 2009 w/o stimulus)

Defense (w/o war costs):	**$556 billion (4.1% increase)**
Non-defense:	**$577 billion (11.5% increase)**
Total :	**$1,133 billion (7.7% increase)**

Defense. The President proposes $556 billion in "regular" budget authority for defense for 2010 (not including war costs, but including the nuclear defense programs in the Department of Energy), which is a 4.1 percent increase over the 2009 level. Over the next four years, the Administration proposes to spend slightly more than the Bush administration had projected spending through 2013 in its final budget submission. This bump-up is probably a result of the transfer of certain programs and activities that had been funded through annual supplementals into the core defense budget, as announced in the press.

It remains to be seen, however, whether even these budget numbers will be sufficient to fully fund the plan for 90,000 additional Army and Marine personnel announced by President Bush and continued by the current administration.

Regarding war costs, the budget claims silly "savings" by imagining new baselines. The current CBO baseline includes only the amount appropriated so far for the war in 2009: about $70 billion. But the President's budget first pretends the war baseline is about $100 billion higher than the amount that has been enacted in 2009, growing by inflation till 2019. Then the budget requests $130 billion for 2010, with an abrupt drop to $50 billion in 2011 and every year thereafter. Therefore it appears to "save" $1.6 trillion.

Apart from baseline games, it is questionable whether allotting a flat $50 billion per year beginning in 2011 is operationally realistic. The President proposes to double troops in Afghanistan for an indefinite period, which may nearly double the current annual $34-billion cost of Afghan operations. At the same time, he proposes to reduce troop levels in Iraq more slowly than initially indicated, to a floor of 30,000-50,000 troops, which would entail substantial residual costs that are not reflected in his request.

Energy. The President's budget assumes $646 billion in net new revenue from the auction of carbon emission credits from 2012-2019. None of this revenue would be devoted to deficit reduction. Instead, the budget proposes to spend $526 billion (about 80 percent) of the new revenue on extension of the Making Work Pay Tax Credit (that was enacted temporarily in the stimulus bill), arguing that this constitutes a rebate to low and middle-income consumers to offset the increase in utility costs that result from the limits on carbon emissions. The remaining $120 billion would be spent on clean energy technologies.

Transportation. The Administration proposes to treat the obligation limitations for transportation programs as discretionary budget authority. Currently, these program are unnecessarily far too confusing: the budget authority is treated as mandatory and the outlays are treated as discretionary. The Administration's proposal would eliminate this split treatment and effectively make the highway and aviation programs look like all other discretionary programs. As a result, discretionary budget authority for transportation increases by about $55 billion a year, total spending and total deficits would not change at all. No legislation is required, but the authorization committees are expected to be hostile to this proposal.

To the extent there is another shortfall in the Highway Trust Fund (HTF) in 2009 and 2010, it is unclear how much of a shortfall the Administration projects and how it proposes to remedy it. Last year, Congress enacted an $8 billion transfer from the general fund to the HTF.

Making good on a campaign promise, the Administration proposes a $5 billion per year Infrastructure Bank for not only transportation, but also public housing, water projects, and energy grid.

IRS. The budget includes a discretionary cap adjustment of $890 million for the Internal Revenue Service to improve taxpayer compliance and assumes that, as a result, tax collections will increase by $17 billion over 10 years. This cap adjustment is nearly twice the size of $490 million one proposed in 2009. The Administration also proposes to narrow the tax gap with an emphasis on overseas tax shelters.

Economic Assumptions

- The Administration's economic assumptions are somewhat rosy.
  - The Administration assumes a shallower recession and a stronger recovery than the February Blue Chip consensus forecast and the February National Association of Business Economists (NABE) forecast.
  - It assumes the unemployment rate will peak at 8.2% in the second and third quarters of 2009. A majority of the Blue Chip economists believe the unemployment rate (a lagging indicator) won't peak until sometime in 2010 and at a higher rate (approaching 9%). The NABE forecast released earlier this week shows the unemployment rate peaking in the fourth quarter of 2009 and the first quarter of 2010 at 9%.

- The Administration assumes the economy will resume growing in the third quarter of 2009. This reflects the majority opinion of the economists surveyed by Blue Chip. Sixty-three percent of those economists surveyed by Blue Chip believe the recession will "eventually be declared to have ended" by the second or third quarters of 2009. The NABE forecast foresees the economy growing again by the third quarter of 2009 as well.

The following groupings compare the Administration's economic assumptions with the latest Blue Chip forecast (from early February), CBO's pre-stimulus January baseline (unless otherwise noted), and the latest NABE forecast.

Real GDP growth CY2009		**Real GDP growth CY2010**		**Real GDP growth CY2011**	
Obama:	-1.2%	Obama:	+3.2%	Obama:	+4.0%
Blue Chip:	-1.9%	Blue Chip:	+2.1%	Blue Chip:	+2.9%
CBO:	-2.2%	CBO:	+1.5%	CBO:	+4.1%
NABE:	-1.9%	NABE:	+2.4%	NABE:	n/a

These data are year-over-year.

Inflation (CPI-U) CY2009		**Inflation (CPI-U) CY2010**		**Inflation (CPI-U) CY2011**	
Obama:	-0.6%	Obama:	+1.6%	Obama:	+1.8%
Blue Chip:	-0.8%	Blue Chip:	+1.8%	Blue Chip:	+2.4%
CBO:	+0.1%	CBO:	+1.7%	CBO:	+1.8%
NABE:	-0.8%	NABE	+1.9%	NABE:	n/a

These data are year-over-year.

Unemployment rate CY2009		**Unemployment rate CY2010**		**Unemployment rate CY2011**	
Obama:	8.1%	Obama:	7.9%	Obama:	7.1%
Blue Chip:	8.3%	Blue Chip:	8.7%	Blue Chip:	5.8%
CBO:	8.5% to 7.7%	CBO:	8.1% to 6.8%	CBO:	7.2% to 6.5%
NABE:	8.4%	NABE:	8.8%	NABE:	n/a

The Obama, Blue Chip, and NABE figures are calendar year averages. The CBO figures are post-stimulus estimates for Q4.

Health and Major Entitlement Programs

Medicare: Without changes Medicare is projected to spend $6.1 trillion over the next 10 years. The President's budget adjusts this amount upward by $330 billion over 10 years by assuming that a legislative fix for the current law reduction in physician payments will be eliminated without offsets. This total of $6.4 trillion is reduced by $6.7 billion through a Program Integrity Allocation Adjustment.

Medicaid: Without changes Medicaid is projected to spend $3.4 trillion over the next 10 years. This total is reduced by $3.1 billion through a Program Integrity Allocation Adjustment ($3.03 billion) and the imposition of Food Safety and Inspection Service performance fee ($44 million).

Reserve Fund for Health Reform: The President's budget creates a 10-year, $634 billion "Health Reform Reserve Fund" to "partially pay" for the administration's yet to be unveiled plan to expand health care coverage. The dollars in this "Reserve Fund" are divided between cuts in Medicare spending and tax increases. The budget assumes these funds are spent on health care reform.

- **Medicare ($316 billion over 10 years).** The President's budget includes a number of policies that reduce Medicare spending by establishing competitive bidding for Medicare Advantage, reducing home health payments, reducing reimbursements for Medicaid prescription drugs, bundling Medicare payments for hospital and post-acute care and providing incentives to hospitals to improve quality. (see table)

- **Tax Increase ($318 billion over 10 years).** The President's budget would limit the tax break on itemized deductions for families with incomes above $250,000. Under current law, a taxpayer who pays a 35% rate on his income may deduct 35% of various expenses -- such as mortgage interest or charitable contributions -- from his taxable income. Under the Obama proposal, these deductions would be limited to a maximum of 28% for all taxpayers.

NIH Cancer Research: The President's budget blueprint does not include a top line number for NIH, however it notes that the President will invest over $6 billion within NIH as part of a multi-year plan to double cancer research. This is in addition to the $10 billion provided in the stimulus bill for NIH research in 2009 and 2010.

FDA Funding: The President's budget blueprint does not include a top line number for the FDA; however it notes that the President will invest over $1 billion for FDA's food safety activities. The President's budget blueprint also includes proposals to allow for the importation of prescription drugs and for the establishment of a FDA approval process for follow-on biologics.

Health Reform Reserve Fund

(millions)

Policy	2010-2019
Penalize hospitals for Medicare readmissions	-8,430
Create hospital quality incentive payments	-12,090
Establish competitive bidding for Medicare Advantage	-176,600
Bundle Medicare payments covering hospital and post-acute settings	-17,840
Implement the use of radiology benefit managers	-260
Apply policies to ensure Medicare pays accurately	-2,040
Reduce reimbursement for Medicaid prescription drugs by (1) increasing the Medicaid rebate amounts, (2) extending rebates to managed care plans, and (3) applying rebates to new formulations of existing drugs	-19,555
Establish a pathway for FDA approval of generic biologics	-9,240
Expand availability of family planning services under Medicaid	-190
Improve Medicaid payments through use of the National Correct Coding initiative	-620
Reduce home health payments	-37,070
Eliminate Medicare and Medicaid Improvement Funds	-23,940
Apply means testing to Part D	-8,130
Total	**316,005**