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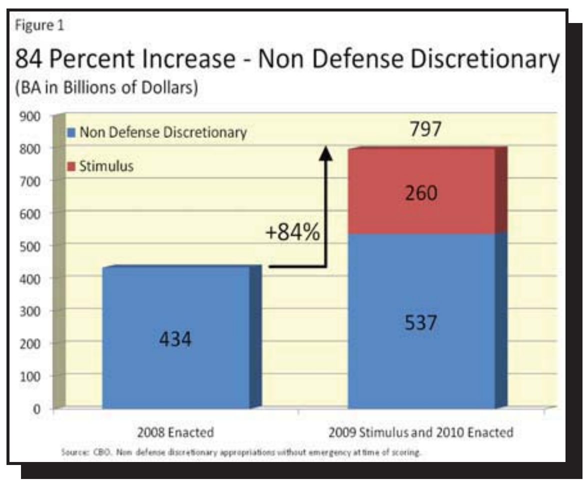
THE OBAMA BUDGET FOR FISCAL YEAR 2011
THE RELENTLESS GROWTH OF GOVERNMENT

2 February 2010

Much like last year, the President's fiscal year 2011 budget presents a staggering contradiction to his recent rhetorical gestures toward "fiscal restraint." It continues pursuing a "progressive" ideology that calls for ever-more centralized government control of the economy. It spends too much, taxes too much, and borrows too much – and the result is a growing debt that drains the resources needed for growth and job creation, undermining any pretense of economic "stimulus." Moreover, the budget adds to an already unsustainable outlook that threatens to overwhelm the budget, smother the economy, and sacrifice the prosperity of future generations.

The President's budget more than doubles the debt; pushes this year's deficit to a new record of $1.6 trillion; drives spending to a new record of $3.8 trillion in fiscal year 2011; and raises taxes by more than $2 trillion through 2020, under the administration's own estimates.

The budget also continues the President's big-government agenda, extending the public sector's reach into, among other things, education, energy, financial institutions, and Americans' health care. The President also proposes another Keynesian-inspired, debt-financed "stimulus" bill – though the administration has banned this discredited term, calling the proposal a "jobs" bill – repeating the failed doctrine of last year's $787-billion attempt. Since taking office, the President has signed measures that increased non-defense discretionary spending by 84 percent over 2 years (see Figure 1).



Against this backdrop, the administration tries to create the illusion of fiscal discipline. The masquerade includes a luke-warm "freeze" on roughly 14 percent of total budget outlays; a pay-as-you-go proposal that promotes higher taxes and locks in deficits at their current high levels; and a "Fiscal Commission" on which the administration relies for any serious proposals to improve the budget outlook.

The discussion below provides a summary and critique of the President's budget proposal for fiscal year 2011.

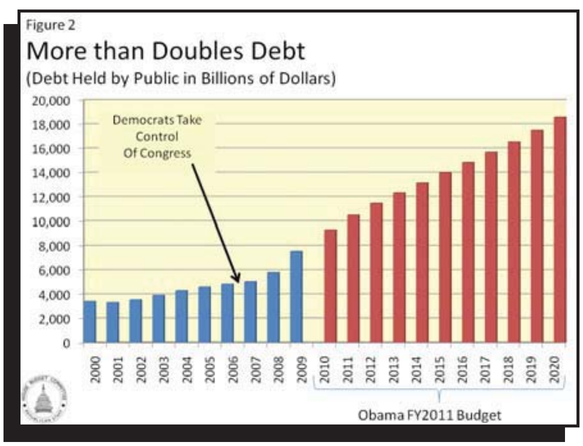
Table 1: The President's Budget for Fiscal Year 2011
(dollars in billions)

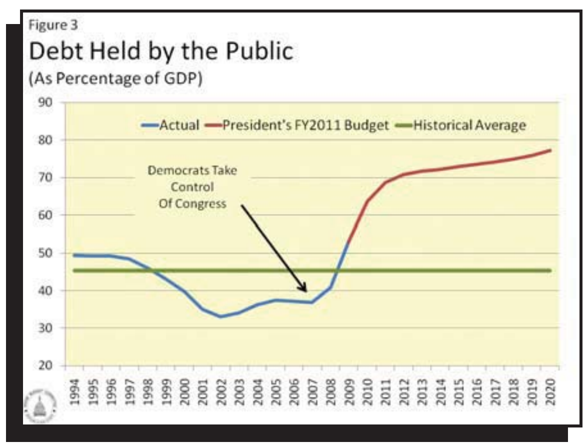
	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Outlays	3,721	3,834	3,755	3,915	4,161	4,386	4,665	4,872	5,084	5,415	5,713
Revenue	2,165	2,567	2,926	3,188	3,455	3,634	3,887	4,094	4,299	4,507	4,710
Deficits											
Dollars	1,556	1,267	828	727	706	752	778	778	785	908	1,003
% of GDP	10.6%	8.3%	5.1%	4.2%	3.9%	3.9%	3.9%	3.7%	3.6%	3.9%	4.2%
Debt Held by the Public											
Dollars	9,298	10,498	11,472	12,326	13,139	13,988	14,833	15,686	16,535	17,502	18,573
% of GDP	63.6%	68.6%	70.8%	71.7%	72.2%	72.9%	73.6%	74.2%	74.9%	75.9%	77.2%

Source: Office of Management and Budget.

DEBT

Debt held by the public more than doubles over 5 years, and triples by fiscal year 2019 from fiscal year 2008 levels. The budget would push the debt to $9.3 trillion this year, or 63.6 percent of gross domestic product [GDP] – the largest debt in history, and the largest debt as a share of the U.S. economy in 59 years. Despite the Senate's passage of a $1.9 trillion increase in the debt limit, Congress would need to increase this limit again before 1 October 2011 under the President's budget. The interest bill on the debt would more than quadruple by the end of the decade, reaching $840 billion in 2020. The debt continues rising throughout the decade, reaching 77.2 percent of GDP by 2020.



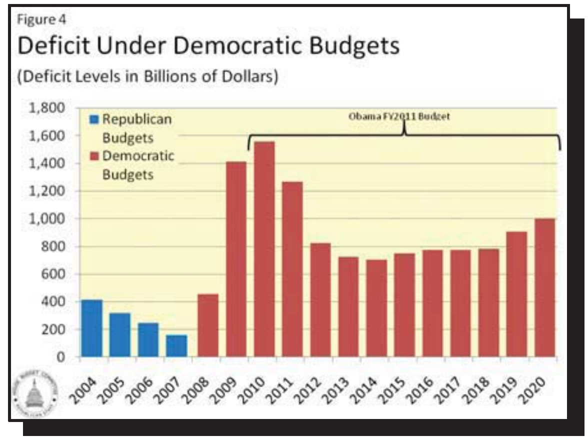


The U.S. has not seen debt at these expected levels since the end of World War II. At that time, the problem was more manageable, because the war ended, and defense spending and debt plunged. The budget was back in balance 2 years after the war, from a deficit that had exceeded 30 percent of GDP in 1943. Today, spending is driven mainly by entitlements, and there is no let-up in these outlays without fundamental reform. But the administration proposes increasing and expanding entitlements – letting the Fiscal Commission figure out how to solve the problem *after* enactment of a huge expansion of government.

Even the countries of the European Union, hardly exemplars of fiscal rectitude, are required to keep their debt levels below 60 percent of GDP.

DEFICITS

The budget boosts the deficit to a record level this year: $1.6 trillion, or 10.6 percent of GDP. This is the largest deficit as a share of the economy since World War II. Deficits never fall below $700 billion, and never below 3.6 percent of GDP – a level the President's budget director has called "unsustainable." After dipping slightly in the middle of the decade – to a "low point" of $706 billion – deficits start growing again, and exceed $1 trillion (4.2 percent of GDP) by the end of the decade.



Yet a year after declaring *A New Era of Responsibility* (a title omitted from the current budget proposal), the President continues blaming his problems on the previous administration. Yet the *smallest* Obama deficits are larger – in nominal dollars, constant dollars, and as a percentage of GDP – than the *largest* recorded from 2001 through 2008. Although President Obama did inherit a large deficit in fiscal year 2009, he shares some accountability for the final tally: he signed the $787-billion "stimulus" in February that year; an omnibus in March that contained nine of the regular appropriations bills for 2009 and caused a 10.3-percent increase in non-defense spending; and a diversion of Troubled Asset Relief Program [TARP] funds to bail out auto makers and homeowners delinquent on their mortgages.

SPENDING

Despite a decline in spending due to the repayment of most TARP funds, and the eventual spend-out of "stimulus" funds, spending reaches a record level of $3.8 trillion in fiscal year 2011. Spending is 23.7 percent of the economy at the end of the decade; the historical average is 20 percent.

Entitlements and Other Mandatory Spending

Health Care. In numerous ways, the budget reflects the deep government intervention in health care that the President is pursuing. It contains net mandatory outlays of $80 billion over 5 years, and $591 billion over 10 years, for health legislation. This does not include $26 billion for the temporary extension of the increased Medicaid Federal Medical Assistance Percentage [FMAP], and it appears to include unspecified reductions in Medicare. Nor does it account for the more than 100 new programs, offices, and bureaucracies included in the House and Senate-passed health bills, all of which require appropriations. (The Congressional Budget Office has yet to estimate the discretionary spending in the House and Senate bills.)

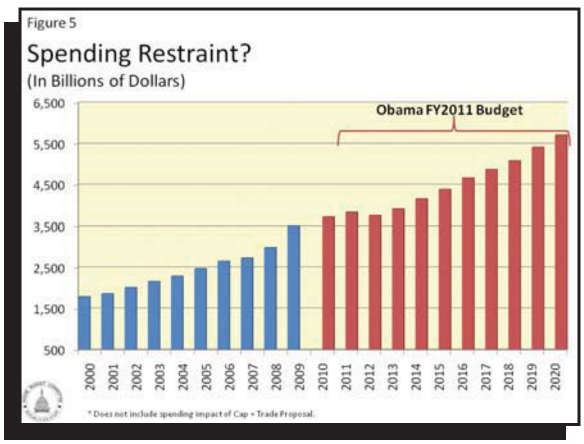
The budget also anticipates a net tax increase for health legislation totaling $204 billion over 5 years and $713 billion over 10 years.

Other significant health spending proposals in the budget:

- EXTENSION OF THE CONSOLIDATED OMNIBUS BUDGET RECONCILIATION ACT [COBRA]. The extension of the 1985 COBRA adds $5.5 billion in spending over 5 years and 10 years. Annually, the figures are $3.2 billion in fiscal year 2010, $5.2 billion in fiscal year 2011, and $227 million in fiscal year 2012.

- THE 'DOC FIX.' The President's budget baseline includes a fix to the Medicare Sustainable Growth Rate [SGR] formula so that physicians will not see reductions in their payments, as scheduled under current law. Including this provision in the baseline avoids any need to account for or offset its considerable cost: $371 billion over 10 years.

The Supplemental Nutrition Assistance Program [SNAP]. The budget expands eligibility for SNAP (formerly known as food stamps) by increasing the asset limit from $2,000 to $10,000 per household, and excluding the receipt of tax refunds from income eligibility requirements. These changes would cost more than $4.5 billion over 5 years.



Increased Spending on Nutrition Programs. The budget spends an additional $10 billion over 10 years on the Child Nutrition and the Special Supplemental Program for Women, Infants, and Children [WIC]. The intent, according to the budget, is to increase program access, improve nutritional quality, and strengthen program management.

New Education Entitlements. The budget further expands government entitlements with the creation of four new mandatory education programs, and the expansion of two existing ones.

- COLLEGE ACCESS AND COMPLETION FUND. This new mandatory spending program is created and funded for 6 years at a cost of $3.4 billion, after which time the program is ostensibly zeroed out.

- GRADUATION PROMISE GRANTS. The budget establishes this new program for high schools, which sunsets after only 5 years.

- EARLY LEARNING CHALLENGE FUND. This is another new program, with a cost of $9-billion over 10 years.

- AMERICAN GRADUATION INITIATIVE. The administration proposes $8.8 billion for this new program, aimed at community colleges.

- HISTORICALLY BLACK COLLEGES. The budget extends $2.45 billion in mandatory funding for Historically Black Colleges and Universities and other minority-serving institutions.

- STUDENT LOAN REPAYMENTS. Finally, the budget provides $7.5 billion to lower the existing cap on Federal student loan repayments from 15 percent of income to 10 percent.

Student Loans. To help offset these new expenses, the budget effectively eliminates the Federal Family Education Loan [FFEL] program, a student loan program that leverages private sector capital and is the largest source of student financial aid. In its place, the budget finances the entire Federal student loan program with U.S. Treasury borrowing.

Department of Health and Human Services [HHS]. Increases in HHS programs include $8.2 billion over 5 years and $9 billion over 10 years for expanded child care; “stimulus” bill child support; the Low-Income Home Energy Assistance Program “trigger”; Temporary Assistance for Needy Families; and teen pregnancy prevention.

TARP. According to the President’s budget, the lifetime net present value cost of the TARP is projected to be almost $127 billion. Although this is roughly $214 billion less than the TARP estimate reported in the 2010 *Mid-Session Review*, costs are heavily weighted toward the administration’s mortgage subsidization and auto programs – both of which fall outside the original intent of TARP – as well as its investment in the American International Group [AIG]. In addition, as announced in the President’s State of the Union Address, the budget proposes spending $30 billion from TARP on a new program to finance small business loans through community banks. Most major financial institutions that received TARP loans vis-à-vis programs designed to stabilize markets have made significant repayments – by the end of 2010, Treasury anticipates that total bank repayments will exceed $185 billion.

Energy Royalties. While touting an increase to support more permitting of renewable energy projects on Federal lands, the administration is – at the same time – re-proposing its “use-it-or-lose-it” fee on oil and gas leases, charging higher royalty fees on oil and gas production, and ending a royalty-in-kind program. Each of these policies tends to reduce domestic production of energy – not increase it.

Discretionary Spending

‘Security’ Spending. The budget alters the commonly used categories for discretionary spending – defense versus non-defense – to “security” and “non-security.” The security spending category consists of the Department of Defense, the Department of Veterans Affairs, State and International Affairs, Homeland Security. Non-security is all other regular appropriated spending. “Stimulus” and emergencies are excluded from both, and Pell Grants are removed altogether from discretionary spending.

The Department of Defense [DoD] represents the majority of the security category. The President’s request for fiscal year 2011 is $549 billion for the Department’s base operations (non-war), an increase of 3.4 percent over the enacted level. The President includes $159 billion for the Global War on Terrorism (renamed "Overseas Contingency Operations [OCO]" by the Obama administration).The request also includes supplemental funding for the current budget year (fiscal year 2010) of $33 billion, which would bring total 2010 war funding totals to $163 billion.

With war costs, total DoD discretionary BA will be $693 billion in 2010 and $708 billion in 2011 or an increase of 2.2 percent. In the years 2012 and beyond, the President assumes a $50 billion placeholder for war spending and assumes an average annual growth for DoD programs of 2.8 percent.

Funding for the other agencies and programs in the "security" category is as follows:

- THE DEPARTMENT OF VETERANS AFFAIRS [VA]. The VA receives $57 billion, an increase of 7.3 percent, for its discretionary programs, which are primarily its hospitals and health programs.

- THE DEPARTMENT OF ENERGY'S NATIONAL NUCLEAR SECURITY ADMINISTRATION. The agency is provided an increase of 13 percent over the enacted level of $9.9 billion.

- THE DEPARTMENT OF HOMELAND SECURITY [DHS]. For the DHS, the request is $43.6 billion, or $4.2 billion higher than the enacted level of $39.4 billion, an increase of 10.7 percent.

- THE DEPARTMENT OF STATE AND OTHER INTERNATIONAL PROGRAMS. These activities receive $58.5 billion, or 15.6 percent increase above the 2010 enacted level and a 53.5-percent increase above the 2009 enacted level.

Table 2: The President's Discretionary Spending
(budgetary resources in billions of dollars)

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Security[a]	683.7	719.2	747.5	768.7	789.7	814.0	834.6	856.5	879.0	902.7	927.6
Non-Security[b]	446.3	441.3	446.4	446.2	459.1	472.3	478.7	488.8	501.6	517.0	537.5
Subtotal: Base Disc.	1,130.0	1,160.5	1,193.9	1,214.9	1,248.8	1,286.2	1,313.3	1,345.3	1380.6	1,419.7	1,465.1
Other											
Overseas Cont.[d]	130.0	159.3	50.0	50.0	50.0	50.0	50.0	50.0	50.0	50.0	50.0
Other "Emergency"	0.4	–	–	–	–	–	–	–	–	–	–
2010 Supplemental[e]	41.1	–	–	–	–	–	–	–	–	–	–
Total Disc. Spending	1,301.5	1,319.8	1,243.9	1,264.9	1,298.8	1,336.2	1,363.3	1,395.3	1,430.6	1,469.7	1,515.1

[a] The President's "security" category comprises funding for the Department of Defense DoD], the National Nuclear Security Administration [NNSA], the Department of Homeland Security [DHS], the Department of Veterans Affairs VA], the Department of State, and Other International Funding.
[b] Non-DoD, non-NNSA, non-DHS, non-VA, non-State, non-international, and non-emergency.
[c] The budget includes a placeholder of $50 billion per year for Overseas Contingency Operations in 2012 and beyond. The figure does not reflect any policy assumptions.
[d] The 2010 requested supplemental includes additional funding for Overseas Contingency Operations.
Source: Office of Management and Budget.

Non-Security. The non-security spending category represents 30.5 percent of total discretionary budget authority [BA] in 2011 (38 percent of base non-war non-emergency discretionary BA). While there is purportedly a "freeze" in this category, the overall average annual growth between the 2011 request and 2020 is 2.8 percent. The growth between 2011and 2012 for these programs (excluding emergencies) is 13.1 percent, and is 23.4 percent between 2009 and 2012. With $260 billion in "stimulus" funding, non-defense discretionary spending has grown by 84 percent.

Some key items:

- YUCCA MOUNTAIN. The budget sends a decidedly mixed signal on nuclear power. While making nuclear power a prominent fixture in his State of the Union speech, the President has decided to withdraw the license application from the Nuclear Regulatory Commission to build Yucca Mountain – which may be in violation of existing law – adding further uncertainty over how to deal with nuclear waste.

- DEPARTMENT OF ENERGY. The Department of Energy budget seeks an overall increase of 6.8 percent for fiscal year 2011, after receiving a 173 percent increase – including "stimulus" for fiscal year 2010.

- THE ENVIRONMENTAL PROTECTION AGENCY [EPA]. After receiving a 35-percent increase in fiscal year 2010 – or 130 percent if "stimulus" is included – the EPA budget for 2011 is flat. Highlights of the request include continued elevated funding for the Clean Water State Revolving Fund – 190 percent over fiscal year 2009 levels – and the Drinking Water State Revolving Fund – 55 percent over 2009.

  The budget also includes a request for $43 million to implement a flawed rulemaking to regulate greenhouse gases under the Clean Air Act. A joint resolution of disapproval – which currently has 40 cosponsors including three Democrats – is currently pending in the Senate.

- THE NATIONAL AERONAUTICS AND SPACE ADMINISTRATION [NASA]. The fiscal year 2011 NASA budget includes a 1.5-percent increase over fiscal year 2010. The budget proposes to end the Constellation program – the agency's manned mission to the Moon and Mars – in favor of exploring new approaches to manned space exploration. The budget proposes to fund a final five shuttle flights through 2011, after which the shuttle program will be retired.

Federal Employment

While unemployment in the private sector has increased, the Federal Government has grown: it has expanded by 15 percent since 2007. Even if the Defense and Commerce Departments are excluded – the latter to account for the large force of temporary hires for the census – Federal civilian employment will have expanded by nearly 14.8 percent since 2007.

According to the President's budget, Federal employment will hold steady in 2011 compared with 2010. But this does not take into account the additional Federal employees who will be needed as a result of cap-and-trade legislation, the planned government takeover of health care, financial regulation, and other components of the President's agenda. For example, as noted above, the health care legislation in the House and Senate creates more than 100 new programs, offices, and bureaucracies, all of which will require staffing.

The budget also acknowledges an administration plan to reduce the amount of contracting out of services promoted by the previous administration, which was aimed at reducing overall government costs. The budget concedes that this effort is part of the reason for increases in Federal full-time equivalents [FTEs]. It criticizes the practice of contracting by saying: "[O]verreliance on contractors can lead to the erosion of in-house capacity that is essential to effective government performance . . . . Such overreliance was encouraged by the one-sided management priorities of the previous administration."

Table 3: Total Civilian Federal Employment
(full-time equivalents in thousands, excluding the Postal Service)

	2007	2008	2009	2010	2011
Cabinet Departments					
Agriculture	94.8	93.9	94.2	101	97.1
Commerce	36.3	37.5	56	141.5	43.6
Defense	658.8	671.2	702.7	720.2	757.5
Education	4.1	4.1	4	4.3	4.6
Energy	14.6	14.7	15.5	16.6	16.9
Health and Human Services	58.8	59.8	63	65.1	68
Homeland Security	148.1	158.2	169.6	177	183.5
Housing and Urban Development	9.5	9.4	9.5	9.7	9.7
Interior	67.4	67.4	68.6	70.6	69.6
Justice	105	106	109.1	119.3	125
Labor	15.9	16	16	17.9	17.9
State	30.1	30.4	30.4	35	35.7
Transportation	53.4	54.7	56.4	57.9	58.6
Treasury	107.7	106.7	108.7	113.5	113.7
Veterans Affairs	230.4	249.5	272	284.3	287.7
Other Agencies (excluding Postal Serv.)					
Agency for International Development	2.4	2.4	2.6	2.8	3.3
Broadcasting Board of Governors	2	2	1.9	2.1	2.1
Corps of Engineers - Civil Works	21.2	21.1	22.2	22.6	22.6
Environmental Protection Agency	17	16.8	17	17.4	17.6
Equal Employment Opportunity Commission	2.2	2.2	2.2	2.5	2.6
Federal Deposit Insurance Corporation	4.5	4.6	5.5	7.6	6.6
General Services Administration	11.9	11.8	12	13	13.3
National Aeronautics and Space Administration	18.2	18.4	18.3	18.6	18.6
National Archives	2.8	2.8	3	3.2	3.3
National Labor Relations Board	1.7	1.6	1.6	1.7	1.7
National Science Foundation	1.3	1.3	1.4	1.4	1.5
Nuclear Regulatory Commission	3.5	3.7	4	4	4
Office of Personnel Management	4.6	4.7	4.7	4.9	5
Peace Corps	1.1	1	1	1.3	1.4
Railroad Retirement Board	1	1	1	1	0.9
Securities and Exchange Commission	3.5	3.5	3.6	3.8	4.2
Small Business Administration	4.4	3.6	3.9	3.5	3.5
Smithsonian Institution	5	5.1	5.1	5.4	5.4
Social Security Administration	61.7	61.3	64.1	67.6	68.4
Tennessee Valley Authority	11.3	11.6	11.5	13	13
All Other Agencies	15.6	15.2	15.6	17.3	17.7
Totals	1,831.6	1,875.3	1,977.8	2,148.3	2,105.7
Totals Excluding Defense and Commerce	1,136.5	1,166.5	1,219.1	1,304.1	1,304.6

Source: Office of Management and Budget, *Analytical Perspectives: Budget of the U.S. Government – Fiscal Year 2011.*

TAXES

The policy proposals in the President's budget would increase tax revenues by more than $2 trillion over 10 years, based on administration estimates. According to descriptions of individual proposals, taxes aimed at higher-income individuals would raise roughly $970 billion over 10 years, while taxes aimed mainly at businesses (dubbed "revenue changes and loophole closers") would raise $468 billion. The balance of the total tax increase is implied in the administration's aggregate revenue figures in its policy baseline. The administration's budget does *not* include the revenue impact of the administration's cap-and-trade proposal ($843 billion according to the Congressional Budget Office estimate of the House-passed cap and trade bill). The budget does appear to assume a tax on those who do not purchase health insurance, but there is no specific line item for this provision.

Among the key tax provisions outlined in the budget are the following:

Expiration of 2001/2003 Tax Relief Provisions for Upper-income Individuals. The proposal would increase the top two income tax brackets from 33 percent to 35 percent, and from 35 percent to 39.6 percent. It also would increase the tax rate on capital gains and dividends from 15 percent to 20 percent for households making more than $250,000 ($200,000 for individuals). It would restore the phase-out of personal exemptions and itemized deductions for such individuals (i.e. the so-called PEP and Pease). These provisions would raise $678 billion over 10 years.

Note that the tax increases aimed at upper-income individuals would also hit small businesses, as three-quarters of filers paying at these top two rates are small-business owners (i.e. S-corporations, partnerships, or sole proprietorships). Under this proposal, a small business would face a top marginal rate of nearly 40 percent, while large businesses would pay the lower 35-percent corporate tax rate.

Cap the Value of Itemized Deductions for Upper-income Individuals. The value of a tax deduction rises with one's marginal tax rate. This proposal would cap the tax rate at which deductions lower tax liability at 28 percent, raising $291 billion over 10 years. This proposal faced strong opposition from Congress last year, as critics pointed out negative consequences such as lower contributions to charitable organizations.

Bank Tax. The administration is proposing a so-called "financial crisis responsibility fee," which is essentially a surcharge on the covered liabilities of some of the largest banks and financial institutions (those with assets in excess of $50 billion). The tax is being imposed to offset the projected cost of TARP. This provision is expected to raise $90 billion over 10 years.

Reform Elements of U.S. International Tax System. The administration wants to create a matching principle so that U.S. multinationals are not allowed to deduct interest expense until the income associated with those expenses is recognized. It also wants to limit the ability of U.S. multinationals to use foreign tax credits to lower U.S. tax liability. In all, the various international tax provisions would raise $122 billion over 10 years.

Carried Interest. Currently, so-called carried interest (a portion of the compensation of some investment fund managers) is characterized as a capital gain. This proposal would tax carried interest at the higher ordinary income tax rate, raising $24 billion over 10 years.

Reduce Tax Gap. Policies would expand tax information reporting and strengthen tax administration in order to narrow the gap between taxes owed and taxes paid. The provisions would raise roughly $49 billion over 10 years.

Oil and Gas Taxes and Fees. While claiming to reduce dependence on foreign oil and putting American's back to work, the budget would make domestic production of fossil energy more difficult by imposing nearly $40 billion in new taxes and fees. This comes on top of the President's decision to delay an offshore oil and gas lease plan that was previously approved in the wake of $4 gasoline and a bipartisan agreement to scrap the moratorium on off-shore drilling.

GIMMICKS AND OTHER CURIOSITIES

War Games Redux. Not unlike last year, the President has claimed substantial saving from the baseline while increasing spending. This impossibility is enabled by the baseline's susceptibility to manipulation. The enacted level for war in 2010 is $130 billion, and the President extends that, with inflation, into the future. Instead of spending the $130 billion in the outyears, the President assigns a $50-billion placeholder and takes credit for "savings" of some $810 billion in spending. Ironically, the President's budget actually increases spending for the war by $33 billion in 2010, and requests $159 billion in 2011 – for which he requested only $50 billion in last year's budget as a placeholder. In short, the savings simply do not exist. This is a repeat of a gimmick employed by the administration in the fiscal year 2010 budget, but is slightly less egregious than last year's version.

Pell Grants and the Census. For fiscal year 2010, Congress appropriated $17.5 billion to fund the discretionary portion of the Pell Grant Program. By shifting all Pell Grant funding to the mandatory side of the ledger, the budget frees up $17.5 billion of discretionary funding the administration no longer has to spend on Pell. This allows new spending in this category while still achieving the appearance of a "freeze." Meanwhile, the Pell Grant Program grows by $118 billion over 10 years to maintain the maximum award established in the "stimulus" bill, and it incurs an additional $69 billion by indexing the award in advance of increases in the consumer price index [CPI].

In fiscal year 2010, spending on the Census Bureau went from $3.9 billion to $6.97 billion, to fund the decennial census. It is from this inflated level that the baseline is projected, giving an additional $3 billion dollars in false savings for "cutting" such funding that was never going to occur anyway.

These two bookkeeping maneuvers give the administration everything needed to achieve the President's non-security "freeze" – without cutting or reducing a single program.

Cap-and-Trade Spending and Revenue. The budget obscures the true size of government by treating cap-and-trade revenues as a "deficit-neutral." Under this treatment, the administration has decided that because all cap-and-trade taxes would be spent on consumer rebates and new government programs, the net budget effect of enacting the program is zero. This, however, ignores the fact that implementing cap-and-trade would drain an additional $873 billion from the economy, all of which would be spent on more government – according to the Congressional Budget Office estimate of the recent House-passed cap-and-trade bill.

Fannie Mae and Freddie Mac. On 24 December 2009, the administration announced that the Department of the Treasury will extend its authority to finance the Federal National Mortgage Association [Fannie Mae] and the Federal Home Loan Mortgage Corporation [Freddie Mac] in *unlimited* amounts for the next 3 years. Yet the President's 2011 budget continues to leave the two government-sponsored enterprises off of the Federal budget. Since September 2008, Fannie and Freddie have operated under the protection of government conservatorship – meaning that the taxpayer ultimately stands behind the $5.3 trillion in loans they own or guarantee. The Congressional Budget Office, concerned about properly accounting for risk, made the decision to place Fannie and Freddie on-budget in 2009, currently reflecting an all-in cost to taxpayers of roughly $370 billion.

BUDGET 'DISCIPLINES'

Spending 'Freeze'

Facing a large budget deficit in fiscal year 2009, the President's immediate response was to *spend and borrow more*. Since taking office, the President has signed appropriations bills and a "stimulus" that have led to an 84-percent increase in non-defense discretionary spending over 2 years.

Now the administration proposes a spending "freeze" that supposedly will help solve the problem. The freeze does not apply until 2012 – *after* the administration has spent even more on items such as another "stimulus." It is also a clear invitation for Congress to pump up 2011 spending beyond the request, in anticipation of the "freeze."

The "freeze" affects only about 14 percent of the budget, exempting defense, homeland security, veterans, international affairs, Pell Grants, and emergencies. It has no means of enforcement, such as spending caps. Finally, it has no effect on the real problem: entitlement spending – for which the administration is turning to its yet-to-be-named Fiscal Commission (see below).

Pay-As-You-Go

Like House Democrats, the President has touted the ostensible benefits of pay-as-you-go [pay-go]. But those benefits, in fact, are overstated.

First, pay-go it does not reduce deficits – it just maintains them at their current level. It does not apply to current law, so it will do nothing to address the unsustainable rate of spending growth in *existing* entitlement programs. In addition, pay-go does nothing to restrain spending – it only claims to "pay for" it. This inevitably means higher taxes. *Indeed, pay-go has become a means of justifying chasing higher spending with higher taxes.*

Pay-go does not apply to annually appropriated discretionary spending, which represents more than $1 trillion of Federal spending. It does not apply to mandatory spending provisions included in appropriations bills.

Finally, even good process reforms are no substitute for genuine discipline. Congress cannot "process" its way to fiscal health. The only way to cure the budget crisis is to adopt real policy reforms that slow the growth of government spending and actually *reduce* deficits and debt.

Fiscal Commission

The most candid expression of the President's fiscal policy appears in Table S-1 on page 146 of the main budget book. It reflects the President's unsustainable budget totals under the label "Without Fiscal Commission." Below the table is a large advertisement for the commission, saying in part: "The Fiscal Commission is charged with identifying policies to improve the fiscal situation in the medium term and to achieve fiscal sustainability over the long run. Specifically, the commission is charged with balancing the budget excluding interest payments on the debt by 2015. The result is projected to stabilize the debt-to-GDP ratio at an acceptable level once the economy recovers." In other words, the commission will make the important policy choices that the President's budget is supposed to make. The budget offers no specifics on the nature of this commission, only saying on page 39, that the administration "will work to create" it.

ECONOMIC ASSUMPTIONS

The administration assumes economic activity will rebound in 2011, expecting real GDP to increase by 3.8 percent, higher than the Blue-Chip private sector consensus of 3.1 percent. Over the medium term, the administration sees GDP growing by greater than 4.0 percent per year, also higher than the Blue Chip consensus.

Table 4: Comparison of Economic Assumptions
(Calendar Years)

	Projections						
	2010	2011	2012	2013	2014	2015	2016
	Percent Change						
Real Gross Domestic Product							
Administration Budget	2.0	3.8	4.3	4.3	4.1	3.6	3.2
CBO (January 2010)	2.2	1.9	4.4	4.4	4.4	2.4	2.4
Blue Chip Consensus (January 2010)	2.8	3.1	3.3	3.0	2.8	2.7	2.6
Consumer Price Index							
Administration Budget	1.4	1.5	1.9	2.0	2.0	2.0	2.1
CBO (January 2010)	2.4	1.3	1.2	1.2	1.2	1.9	1.9
Blue Chip Consensus (January 2010)	2.1	2.0	2.1	2.2	2.3	2.4	2.4
	Annual Average, Percent						
Unemployment Rate							
Administration Budget	9.8	8.6	7.7	6.8	5.9	5.6	5.5
CBO (January 2010)	10.1	9.5	6.5	6.5	6.5	5.0	5.0
Blue Chip Consensus (January 2010)	10.0	9.2	8.1	7.3	6.7	6.2	5.8
3-Month Treasury Bill Rate							
Administration Budget	1.3	2.6	3.8	4.0	4.0	4.0	4.0
CBO (January 2010)	0.2	0.7	2.9	2.9	2.9	4.6	4.6
Blue Chip Consensus (January 2010)	0.4	1.8	3.3	3.7	4.0	4.2	4.2
10-Year Treasury Note Rate							
Administration Budget	4.5	4.9	5.2	5.2	5.2	5.2	5.2
CBO (January 2010)	3.6	3.9	4.5	4.5	4.5	5.5	5.5
Blue Chip Consensus (January 2010)	3.9	4.6	5.0	5.1	5.2	5.3	5.4

Sources: Office of Management and Budget, Congressional Budget Office, Blue Chip Economic Indicators.

The Office of Management and Budget [OMB] expects the unemployment rate to peak at an average of 10.0 percent this year and only slowly decline. The unemployment rate does not return to its pre-crisis level of roughly 5.0 percent throughout the 10-year horizon (though it reaches 5.2 percent toward the end of the decade).

OMB assumed that inflation will generally remain contained throughout the decade as the consumer price index [CPI] only increases by a modest 2.0 percent each year over the medium term.

As economic conditions strengthen and financial conditions normalize, long-term interest rates are expected to gradually increase in the coming years from their current record-low levels. The yield on the 10-year Treasury is expected to rise back up to 5.0 percent by 2012, in line with the Blue Chip consensus, but well below levels in the 1980s and 1990s, when debt was a much smaller share of GDP.

The budget is quite sensitive to the economic forecast. If GDP growth is lower than expected, or if borrowing rates are higher-than-expected, deficit levels would worsen. For instance, OMB calculates that if interest rates are 1 percentage point higher than they are currently forecast throughout the budget horizon, deficits would increase by a total of $845 billion.