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**MORE DETAILS ON THE PRESIDENT'S FY 2009 BUDGET**

**FEBRUARY 21, 2008**

As the Committee pointed out in its earlier release (FY 2009 Budget), the President's Budget reaches balance in 2012 only through a number of questionable assumptions regarding future fiscal policy. This update will extend that analysis by looking in more detail at the policy and baseline assumptions that underlie the Administration's budget request.

**The President's Policy Assumptions**

Over the two-year period 2008-2009, the President's Budget increases the deficit by a total of \$400 billion above the OMB baseline. This increase is the result of both the war spending that will be enacted in the current calendar year and the economic stimulus package. Over the 2009-2013 budget window, discretionary outlays are above the OMB baseline (which does not extend emergencies enacted in fiscal year 2007), but are more than offset by net savings in mandatory programs like Medicare (see Table 1 below). Those savings also offset the interest cost of the stimulus package, the one-year AMT patch, and other tax law changes. Under these assumptions, the budget yields small surpluses in 2012 and 2013.

**Receipts**

The OMB baseline assumes the extension of the 2001 and 2003 tax cuts, which will lower receipts by \$635 billion (and increase outlays for refundable tax credits by \$31 billion) during 2009-2013. It should also be noted that the bulk of the stimulus package assumed in the budget affects the 2008 fiscal year (-\$125 billion in receipts), and results in small revenue increases (\$8 billion over 2009-2013) in later years.

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**Table 1.**  
**Comparison of Administration Policy and Baseline**  
 (By fiscal year in billions of dollars)

	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2009-2013</u>
<b>TOTAL RECEIPTS</b>								
Policy	2,568	2,521	2,700	2,931	3,076	3,270	3,428	15,405
Baseline	<u>2,568</u>	<u>2,662</u>	<u>2,815</u>	<u>2,954</u>	<u>3,110</u>	<u>3,301</u>	<u>3,454</u>	<u>15,634</u>
Policy less Baseline	--	-140	-115	-23	-34	-31	-26	-228
<b>Outlays</b>								
<i>Discretionary</i>								
Policy	1,042	1,137	1,212	1,100	1,059	1,056	1,062	5,489
Baseline	<u>1,042</u>	<u>1,109</u>	<u>1,092</u>	<u>1,057</u>	<u>1,070</u>	<u>1,090</u>	<u>1,114</u>	<u>5,423</u>
Policy less Baseline	--	28	120	43	-11	-34	-52	66
<i>Mandatory</i>								
Policy	1,451	1,551	1,636	1,711	1,818	1,866	2,034	9,065
Baseline	<u>1,451</u>	<u>1,551</u>	<u>1,653</u>	<u>1,746</u>	<u>1,864</u>	<u>1,918</u>	<u>2,065</u>	<u>9,246</u>
Policy less Baseline	--	--	-17	-35	-45	-51	-30	-178
<i>Net Interest</i>								
Policy	237	244	260	280	294	300	302	1,436
Baseline	<u>237</u>	<u>241</u>	<u>249</u>	<u>262</u>	<u>274</u>	<u>280</u>	<u>284</u>	<u>1,349</u>
Policy less Baseline	--	3	11	18	20	20	18	87
<b>TOTAL OUTLAYS</b>								
Policy	2,730	2,932	3,107	3,091	3,171	3,222	3,399	15,990
Baseline	<u>2,730</u>	<u>2,901</u>	<u>2,993</u>	<u>3,065</u>	<u>3,207</u>	<u>3,289</u>	<u>3,464</u>	<u>16,018</u>
Policy less Baseline	--	31	114	26	-36	-67	-65	-28
<b>DEFICIT (-)/SURPLUS</b>								
Policy	-162	-410	-407	-160	-95	48	29	-585
Baseline	<u>-162</u>	<u>-239</u>	<u>-178</u>	<u>-111</u>	<u>-97</u>	<u>12</u>	<u>-10</u>	<u>-384</u>
Policy less Baseline	--	-171	-229	-49	2	36	39	-201

CRFB calculations based on OMB data. Details do not add to totals due to rounding.

The next-largest loss of revenue over the 2009-2013 period results from a new standard income tax deduction for health insurance. This proposal would move the tax preference for health insurance to the individual and cap it, while removing the current unlimited tax deduction received by employers. The proposal would cost \$106 billion over the next 5 years (\$94 billion in revenues and \$12 in outlays; see Table 2 below), but would improve the deficit situation over the next 10 years since the standard deduction would not rise as rapidly as health care costs. While this is the type of change that should be debated, it is unlikely to receive serious consideration this year.

The Administration's proposed tax package understates likely revenue reductions. Omitting some kind of reform the AMT is unrealistic. Over 5 years, the President's tax proposals may understate the cost of continued AMT patches by \$372 billion—including \$103 billion in 2012 alone—based upon CBO's estimates of the cost of annual AMT patches and their interaction with the continuation of the 2001 and 2003 tax cuts.

Not only will Congress almost certainly patch the AMT, but it is also likely to enact other proposals, such as extending the Research and Experimentation (R&E) credit and establishing new, revenue-reducing trade agreements. It is also possible that some proposed compliance items, such as additional reporting to better enforce the tax law, will be adopted as offsets for other legislation.

**Table 2.**  
**Receipts Proposals**  
(Fiscal years 2009-2013 in billions)

<b>Proposals That Reduce Receipts</b>	
Standard Deduction for Health Insurance	-94
R&E Credit (permanent)	-51
AMT Relief (1 year)	-47
Airport and Airways Trust Fund	-29
Trade Bills	-11
Small Business Expensing	-5
Other Extenders	-5
Expand Health Savings Accounts	-4
Charitable Giving Incentives	-4
Other	-6
<b>Total</b>	<b>-256</b>
<b>Proposals That Increase Receipts</b>	
Tax Compliance	11
IRAs with Tax-Free Earnings	8
Stimulus	8
UI Integrity	1
<b>Total</b>	<b>28</b>
<b>NET EFFECT</b>	<b>-228</b>

CRFB calculations based on OMB Table S-7.

### Discretionary Spending

As noted above, the Administration projects discretionary outlays above the baseline for 2009-2013, principally because the President requests war supplementals of \$108 billion in budget authority for 2008 and \$70 billion for 2009. After 2010, discretionary outlays would be reduced below baseline.

Excluding supplemental and emergency funding, the Administration proposes a 4.9 percent increase in total discretionary appropriations (budget authority) in 2009, and a 1.0 percent increase each year between 2010 and 2013. While the budget authority increase proposed for 2009 is roughly in line with the nominal growth in GDP, the increase proposed for years after 2009 is only half the rate of inflation. Given that discretionary budget authority growth has rarely been held to the rate of inflation, it will be difficult for Congress to hold to this assumption for years after 2009.

Calculations based on CBO scenarios for discretionary appropriations suggest the President's request may understate discretionary spending by about \$397 billion over 5 years, including about \$121 billion in 2012 alone. In addition, the budget omits costs of the Iraq War beyond early 2009. This would understate discretionary outlays by another \$26 billion in 2012 based on the assumption that troop strength would be reduced to 75,000 in 2013.

### Mandatory Spending

The Administration proposes net reductions in mandatory spending of \$178 billion over 2009-2013, consisting of \$244 billion in savings offset by \$66 billion in new spending. The largest savings (\$178 billion; see Table 3) come from changes in Medicare, with changes in Medicaid providing savings as well (\$17 billion). The largest spending increases would establish personal accounts in the Social Security program beginning in fiscal year 2013 (\$30 billion), followed by an increase in the amounts authorized for the State Children's Health Insurance Program (SCHIP; \$19 billion). It is worth noting the similarity between the Medicaid savings and SCHIP program increases, which suggests that the Administration supports changes in health care for children only if they can be offset within the program.

**Table 3.**  
**Policy Proposals Regarding Mandatory Spending**  
(Fiscal years 2009-2013 in billions)

<b>Spending Decreases</b>	
Medicare	-178
Medicaid	-17
PBGC Premiums	-9
Social Services Block Grant	-7
Program Integrity	-7
Student Loans	-6
Disability Insurance	-4
Spectrum	-3
Refundable Tax Credits	-3
Other	-10
<b>Total</b>	<b>-244</b>
<b>Spending Increases</b>	
Social Security Personal Accounts	30
State Children's Health Insurance	19
Standard Deduction for Health Insurance	12
Farm Bill Reauthorization	3
TANF Supplemental Grants	2
<b>Total</b>	<b>66</b>
<b>NET EFFECT</b>	<b>-178</b>

CRFB calculations based on OMB Table S-6.

### **The President's Baseline Assumptions**

As has been the case for the past several years, the Administration presents a baseline that assumes enactment of changes that it advocates in the preparation of the baseline. Principally, these include assuming that tax reductions enacted under reconciliation procedures in 2001 and 2003 should not be assumed to sunset, and that emergency-designated appropriations are not extended in the baseline. These differences mean that the OMB baseline is not directly comparable with the CBO baseline released in late January. Fortunately, both CBO and OMB provide enough information so that it is possible to develop an "apples to apples" comparison of the OMB baseline with the CBO baseline.

Table 4 makes that comparison. As can be seen on the table, the OMB baseline assumes both higher spending and higher receipts than the CBO baseline. On net, the OMB baseline shows smaller deficits than the CBO baseline. This seems to stem both from OMB's assumption that labor compensation will return to its historical averages as a share of GDP (up from low levels in 2007), and OMB's slightly more robust GDP forecast. These assumptions boost taxable income and receipts, but not so much so as to suggest the Administration has resorted to a rosy scenario to achieve balance.

**Table 4.**  
**Comparison of CBO and OMB Baseline**  
(By fiscal year in billions of dollars)

	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2009-2013</u>
TOTAL RECEIPTS (Assume 2001 and 2003 tax cuts in base)								
CBO Baseline	2,568	2,654	2,814	2,901	3,034	3,188	3,303	15,241
OMB Baseline	<u>2,568</u>	<u>2,662</u>	<u>2,815</u>	<u>2,954</u>	<u>3,110</u>	<u>3,301</u>	<u>3,454</u>	<u>15,634</u>
CBO less OMB	--	-8	-1	-53	-76	-113	-151	-393
Outlays								
Discretionary (Extend emergencies in base)								
CBO Baseline	1,042	1,089	1,121	1,145	1,170	1,186	1,216	5,838
OMB Baseline	<u>1,042</u>	<u>1,109</u>	<u>1,146</u>	<u>1,155</u>	<u>1,177</u>	<u>1,201</u>	<u>1,228</u>	<u>5,907</u>
CBO less OMB	0	-20	-25	-10	-7	-15	-12	-69
Mandatory								
Social Security								
CBO Baseline	581	611	646	682	719	761	807	3,615
OMB Baseline	<u>581</u>	<u>610</u>	<u>645</u>	<u>682</u>	<u>722</u>	<u>765</u>	<u>814</u>	<u>3,628</u>
CBO less OMB	0	1	1	0	-3	-4	-7	-13
Medicare (Net of Offsetting Receipts)								
CBO Baseline	370	385	411	433	477	475	533	2,329
OMB Baseline	<u>371</u>	<u>391</u>	<u>420</u>	<u>449</u>	<u>495</u>	<u>495</u>	<u>553</u>	<u>2,412</u>
CBO less OMB	-1	-6	-9	-16	-18	-20	-20	-83
Medicaid and SCHIP								
CBO Baseline	197	215	231	249	266	287	309	1,341
OMB Baseline	<u>197</u>	<u>211</u>	<u>224</u>	<u>239</u>	<u>256</u>	<u>275</u>	<u>297</u>	<u>1,291</u>
CBO less OMB	-0	4	7	10	10	12	12	50
Other Mandatory								
CBO Baseline	302	339	366	373	383	361	374	1,857
OMB Baseline	<u>302</u>	<u>338</u>	<u>364</u>	<u>376</u>	<u>391</u>	<u>383</u>	<u>401</u>	<u>1,915</u>
CBO less OMB	0	1	2	-3	-8	-22	-27	-58
Total Mandatory								
CBO Baseline	1,450	1,550	1,654	1,737	1,846	1,884	2,022	9,142
OMB Baseline	<u>1,451</u>	<u>1,550</u>	<u>1,653</u>	<u>1,746</u>	<u>1,864</u>	<u>1,918</u>	<u>2,065</u>	<u>9,246</u>
CBO less OMB	-1	-0	1	-9	-18	-34	-43	-104
Net Interest								
CBO Baseline	238	234	241	266	287	300	313	1,407
OMB Baseline	<u>237</u>	<u>241</u>	<u>250</u>	<u>266</u>	<u>278</u>	<u>285</u>	<u>289</u>	<u>1,368</u>
CBO less OMB	1	-7	-9	0	9	15	24	39
TOTAL OUTLAYS								
CBO Baseline	2,731	2,873	3,015	3,148	3,299	3,355	3,524	16,341
OMB Baseline	<u>2,730</u>	<u>2,900</u>	<u>3,049</u>	<u>3,167</u>	<u>3,319</u>	<u>3,404</u>	<u>3,582</u>	<u>16,521</u>
CBO less OMB	1	-27	-34	-19	-20	-49	-58	-180
DEFICIT (-)/SURPLUS								
CBO Baseline	-163	-219	-201	-247	-264	-167	-221	-1,100
OMB Baseline	<u>-162</u>	<u>-238</u>	<u>-234</u>	<u>-213</u>	<u>-209</u>	<u>-103</u>	<u>-128</u>	<u>-887</u>
CBO less OMB	-1	19	33	-34	-55	-64	-93	-213

CRFB Calculations based on CBO and OMB data.

In light of recent events such as fourth quarter growth below 1 percent and two interest rate cuts in 2 weeks, the Administration's baseline revenue assumption may prove to be overly optimistic. Still, it would not have been clear that this was the case when the economic forecast was finalized in late November.

### **A More Realistic 2012 Deficit Estimate**

This paper has pointed out places where the policy assumptions made by the Administration have made the 2012 deficit seem smaller than it likely will be. Those different assumptions are pulled together in Table 5, below. Acknowledging that costs for wars in Iraq and Afghanistan are likely to continue for several years, that discretionary appropriations likely will not be held to below-inflation growth, and that the AMT patch has become an annual ritual leads us to estimate a deficit of \$223 billion in 2012.

Even this number may prove to be too small, however. Given the current weakness in the economy and the unlikelihood that Congress will act on the President's recommendations for reducing Medicare spending, it is quite possible that the deficit in 2012 will be far larger than the \$233 billion shown here.

**Table 5.**  
**FY 2012 Deficit After Removing**  
**Certain Budget Assumptions**  
(In billions of dollars)

Projected Budget Surplus	48
Additional War Costs	-26
Out year Discretionary at GDP	-121
One-year AMT Patches	-103
Additional Debt Service	-21
Possible Budget Deficit	-223

CRFB Calculations based on CBO and OMB data.