A First Look at the President's FY2010 Budget Blueprint
February 26, 2009

Today, the White House released an outline of its FY2010 budget. Although the President is ordinarily required to submit his budget request to Congress on the first Monday in February, new Presidents are typically given additional time. A more comprehensive budget will be released this spring.

Main Points:

- We commend the Administration for having a specific fiscal goal. They propose cutting the deficit from $1.17 trillion in FY2010 to $533 billion in FY2013. However, we worry that this goal is not nearly aggressive enough given their assumptions that the economy will have recovered fully by that point.

- We are pleased that the budget accounts for many policies that have been omitted in recent budgets, such as the cost of patching the Alternative Minimum Tax and funds for operations in Iraq and Afghanistan. However, we are very concerned that by putting these policies not just in the budget, but in the baseline, the Administration exempts itself from having to pay for these policies (such as making the 2001 and 2003 tax cuts permanent).

- We are encouraged the Administration not only expresses support for pay-as-you-go (PAYGO) budget rules, but proposes to fully-offset their new tax cut and health care plans. There will be a lot of political pressure to drop the offsets for these proposals, and it is critically important they continue to insist on not allowing these new policies to increase the deficit.

Key Points on the Budget

Budget Deficits:

For FY2010, President Obama has proposed to spend $3.6 trillion – or 24.1 percent of GDP, while raising $2.4 trillion in revenue – or 16.2 percent of GDP. This will leave a budget deficit of $1.2 trillion (8% of GDP), roughly $580 billion less than what he projects for 2009. The President's budget gradually shrinks the deficit to $533 billion (3% of GDP) by 2013, before it begins to expand again, reaching $712 billion (3.1% of GDP) in 2019. These deficits are far more severe than those projected for President Bush's FY2009 budget, although most of the differences are due to differing assumptions and changes stemming from the current economic crisis.

Fig. 1: Ten Year Budget Projections (billions and percent of GDP)

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2010-2019
Revenue	$2,186	$2,381	$2,713	$3,081	$3,323	$3,500	$3,675	$3,856	$4,042	$4,234	$4,446	$35,250
Outlays	$3,938	$3,552	$3,625	$3,662	$3,856	$4,069	$4,258	$4,493	$4,678	$4,868	$5,158	$42,219
Deficit	**-$1,752**	**-$1,171**	**-$912**	**-$581**	**-$533**	**-$570**	**-$583**	**-$637**	**-$636**	**-$634**	**-$712**	**-$6,969**
Revenue	15.4%	16.2%	17.5%	18.7%	19.0%	19.0%	19.1%	19.2%	19.3%	19.3%	19.5%	18.7%
Outlays	27.7%	24.1%	23.4%	22.2%	22.0%	22.1%	22.2%	22.4%	22.3%	22.2%	22.6%	22.6%
Deficit	**-12.3%**	**-8.0%**	**-5.9%**	**-3.5%**	**-3.0%**	**-3.1%**	**-3.0%**	**-3.2%**	**-3.0%**	**-2.9%**	**-3.1%**	**-3.9%**
CBO Deficit Projections from Last Year's Budget	**-$342**	**-$182**	**-$129**	**$0**	**-$21**	**-$20**	**-$29**	**-$64**	**-$3**	**$73**	**N/A**	**N/A**
	-2.3%	**-1.2%**	**-0.8%**	**0%**	**-0.1%**	**-0.1%**	**-0.1%**	**-0.3%**	**0%**	**0.3%**	**N/A**	**N/A**

A New Baseline:

In constructing their budget baseline – the metric against which the costs of policy changes are measured – the Administration departed from the practice of assuming a "current-law" baseline, and instead decided to use a "current-policy" baseline. A current-law baseline assumes that changes in the budget will occur as they are scheduled to under the law (i.e. provisions scheduled to expire will be allowed to do so). Instead, Obama's baseline assumes: 1) the practice of patching the AMT on an annual basis will continue; 2) all of the 2001/2003 tax cuts will be made permanent; 3) the wars in Iraq and Afghanistan will continue to cost as much as in FY2008 (inflation adjusted); 4) Congress will continue to enact "Medicare Pay Patches;" and 5) funding will be allotted for anticipated disaster relief.

The published Congressional Budget Office (CBO) current law baseline has not yet been updated to reflect Economic Recovery and Reinvestment legislation and the 2009 appropriations. We updated it in the table below, though we cannot fully account for interest effects.

Taken together, the measures in the Obama baseline will increase this new current law baseline deficit by $482 billion (excluding interest) in FY2013 and more than $5 trillion over ten years. (Interest payments account for another $1.5 trillion over ten years, but some of this is due to already-enacted legislation such as the economic stimulus). President Obama will use this baseline, rather than a current-law baseline, to assess whether new policies meet the goal of budget neutrality, and from this metric his proposals reduce the deficit by roughly $2 trillion over ten years.

Fig. 2: The President's Budget Baseline (billions)

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2010-2019
BEA Baseline Deficit	$1,212	$651	$459	$194	$101	$84	$53	$71	$30	-$23	-$6	$1,614
Enacted Legislation	$216	$364	$158	$63	$55	$53	$37	$26	$25	$27	$27	$835
Current-Law Baseline	**$1,427**	**$1,014**	**$618**	**$257**	**$156**	**$137**	**$90**	**$97**	**$56**	**$3**	**$22**	**$2,449**
Index AMT to Inflation		$15	$72	$34	$39	$46	$54	$63	$73	$84	$96	$576
Renew 2001/2003 Tax Cuts	$0	$6	$154	$234	$264	$294	$315	$330	$345	$361	$378	$2,681
Fund Overseas Operations and Other Anticipated Emergencies	$81	$124	$133	$137	$142	$148	$153	$158	$163	$167	$172	$1,496
Continue Other Policies		$13	$23	$28	$36	$41	$42	$40	$33	$29	$31	$317
Changes to Baseline	**$81**	**$157**	**$382**	**$433**	**$482**	**$530**	**$565**	**$591**	**$613**	**$641**	**$677**	**$5,070**
Debt Service*	**$1**	**$6**	**$34**	**$68**	**$96**	**$125**	**$156**	**$190**	**$224**	**$262**	**$303**	**$1,464**
Current-Policy Baseline	**$1,509**	**$1,178**	**$1,033**	**$758**	**$734**	**$791**	**$811**	**$878**	**$893**	**$906**	**$1,002**	**$8,983**

* Includes interest payments on both already-enacted and anticipated legislation

Economic Assumptions:

The economic assumptions in the President's budget differ somewhat, although not substantially, from those made by the CBO in January. The President's budget predicts a less severe recession (with regards to GDP and unemployment), with vibrant growth rates beginning at some point in 2010 (rather than 2011). In part, these projections are more optimistic because they account for the effects of the recently-passed stimulus bill. Still, their assumptions are rosier than what the private sector is predicting, and as a result they are able to reduce the deficit at a faster rate than they would otherwise be able.

Fig. 3: Economic Assumptions

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Real GDP											
2010 Budget	-1.2%	+3.2%	+4%	+4.6%	+4.2%	+2.9%	+2.6%	+2.6%	+2.6%	+2.6%	+2.6%
CBO (Jan 2009)	-2.2%	+1.5%	+4.2%	+4.4%	+4.1%	+3.5%	+2.8%	+2.5%	+2.3%	+2.2%	+2.2%
Blue Chip Consensus	-1.9%	+2.1%	+2.9%	+2.9%	+2.8%	+2.7%	+2.7%	+2.7%	+2.7%	+2.7%	+2.7%
Consumer Price Index											
2010 Budget	-0.6%	+1.6%	+1.8%	+2%	+2.1%	+2.1%	+2.1%	+2.1%	+2.1%	+2.1%	+2.1%
CBO (Jan 2009)	+0.1%	+1.7%	+1.8%	+2%	+2.2%	+2.2%	+2.2%	+2.2%	+2.2%	+2.2%	+2.2%
Blue Chip Consensus	-0.8%	+1.8%	+2.4%	+2.5%	+2.4%	+2.5%	+2.4%	+2.3%	+2.3%	+2.3%	+2.3%
Unemployment Rate											
2010 Budget	8.1%	7.9%	7.1%	6%	5.2%	5%	5%	5%	5%	5%	5%
CBO (Jan 2009)	8.3%	9%	8%	6.8%	5.8%	5.1%	4.9%	4.8%	4.8%	4.8%	4.8%
Blue Chip Consensus	8.3%	8.7%	5.8%	5.5%	5.3%	5.2%	5.1%	5.1%	5.1%	5.1%	5.1%

Major Policy Changes:

President Obama has proposed a number of major policy changes in tax, energy, and health care policy. Among these changes, Senator Obama has reserved $634 billion for health care reform. Although many details of his health plan are forthcoming, roughly half of it will be financed from savings in Medicare and Medicaid, and the other half by limiting the rate at which itemized reductions can reduce tax liabilities to 28 percent. The budget also suggests that the Administration might call for additional health care spending, but that they would find new offsets to finance it.

In addition, the Administration has proposed renewing the $400 per person "Making Work Pay Tax Credit" originally enacted in the stimulus package, offering or renewing a number of other individual and corporate tax reductions, and increased spending for energy, education, and other initiatives. The initiatives will be financed primarily by auctioning permits in a carbon cap-and-trade program and by closing certain tax loopholes. The Administration also claims significant savings from ending the war in Iraq and allowing the tax cuts for those making over $250,000 a year to expire. Other savings come from reducing spending on farm subsidies and certain other programs.

Fig. 4: Major Policy Changes (billions)

Policy	10-Year Costs
Baseline Deficit	**$8,983**
Specified Health Care Reform	$634
Making Work Pay Credit	$526
Other Tax Reductions	$415
Other Policies	$483
Deficit-Increasing Policies	**$2,058**
Health Care Savings	-$316
Limit Tax Deductions for High Earners	-$318
Carbon Permit Auctions	-$646
Close Tax Loopholes	-$354
End War in Iraq	-$1,490
Allow Upper-Income Tax Cuts to Expire	-$637
Deficit-Reducing Policies	**-$3,761**
Interest Savings	**-$311**
Total Deficit	**$6,969**

Our Thoughts on the Budget

Earlier this week, the Committee for a Responsible Federal Budget recommended that Obama's budget include: 1) Ten Year Budgeting; 2) Reasonable Budget Assumptions; 3) Clear Fiscal Goals; 4) Deficit-Reducing Policies; and 5) Process Reform. We are, in many ways, pleased with this budget outline, which includes some measure of each of the recommendations above. At the same time, we have a number of concerns.

Fiscal Goal:

- We commend the Administration for having a specific fiscal goal, but we believe that if the economy is performing as projected, there should be a more aggressive deficit reduction plan. Although smaller than current levels, a $533 billion deficit is still larger than at any time in the post-war era. Furthermore, under the President's budget, deficits begin to get worse after FY2013, reaching $712 billion in FY2019. We are disappointed that they lay out a fiscal goal that is achieved by how they construct the baseline rather than specific policy changes.

- The "X-factor" for the deficit reduction goal is economic performance. If the economy underperforms, policymakers will have to focus more on economic recovery, and in all likelihood additional deficit-financed policies will be required. If the economy performs as well as projected or better, the deficit goal is quite conservative. We believe that any fiscal goal should remain highly flexible to reflect where we are in any recovery process.

Baseline:

- The budget includes many policies that have been omitted in recent budgets, such as the cost of patching the Alternative Minimum Tax and funds for operations in Iraq and Afghanistan. The Administration should be commended for the increase in transparency in the budget resulting from including the policies they support. This is a vast improvement on the past practice of omitting policies that would clearly be part of the budget.

- However, by putting these policies not just in the budget, but in the baseline, the Administration gives itself a free pass on paying for patching the AMT, making the 2001 and 2003 tax cuts permanent, and the costs of not abiding by the slated Medicare physical payment cuts. Choosing not to offset the costs of these policies is a clear violation of the PAYGO principle, where the cost of new policies should be offset through additional savings.

- Assuming that war spending will continue at FY2008 levels (adjusted for inflation) – an amount even beyond what President Bush's policy would have required – strikes us as a gimmick to build up the spending amount in order to reduce it and claim "savings". We believe the Administration should have included war costs at the levels they are proposing.

- We are gratified that this budget did not rely on "repealing" the 2001/2003 tax cuts for upper-earners and using the money to offset the costs of other policies such as health care spending, a policy they espoused during the campaign. Since these tax cuts are slated to expire at the end of the decade, we do not see the practice of assuming they would be permanent without paying for them, and then repealing them, as a means of generating real savings. Thus their current policy of merely assuming the tax-cut repeal goes for deficit reduction is less of a gimmick.

Health Care:

- We commend the Administration for committing to the goal of a budget-neutral rather than deficit-financed health care plan. We find it immensely encouraging that they have laid out a long list of policies that would not only offset the costs of health care expansion, but would, importantly, slow the growth of health care spending. Assuming the savings materialize, they will have critically important and positive effects on the long-term budget.

- More savings will likely be needed to offset the costs of the types of health care proposals that are being considered. We encourage Congress and the Administration to consider all possible options for filling in the financing gap.

- On one hand we worry that now is not the time to be pursuing major new spending initiatives such as health care coverage expansion and additional tax cuts. The national agenda is already packed with economic challenges, and once the economy has stabilized, the looming fiscal challenges must be addressed next. We would strongly prefer to focus on fiscal issues before any new government spending or tax cuts not related to economic recovery are considered. That said, we recognize that health care coverage was a central theme of the election and there is strong support for pursing an expansion of coverage. Given that, we commend the Administration for insisting that any policy be fully paid for and very strongly hope they stick to this commitment.

The Long-Term:

- This budget puts insignificant focus on addressing the nation's long-term fiscal realities. The Administration does identify a number of savings in Medicare and Medicaid; and if they materialize, they could be critically important to addressing unsustainable entitlement growth. However, these savings are dedicated entirely to financing the President's health care reform initiatives – and are insufficient even to do that. Moreover, this budget remains silent on Social Security, and does not appear to put the budget back on a sustainable path.

Budget Process:

- We are gratified to see the vast improvement in the budget in the way emergencies are budgeted for.

- We are concerned about the recent increase in discretionary spending in the FY2009 omnibus and would have liked to see strong discretionary spending caps in the budget.

- We have long supported PAYGO and are gratified the Administration supports the policy though we strongly disagree with the practice of sticking things in the baseline in order to avoid offsetting the costs. Rather changes should be made to PAYGO and the baseline construction to rationalize the process.

What Critics Will Say:

- Many will criticize the budget for raising taxes. The budget actually includes many tax cuts, including a patch for the AMT, an extension of most of the

2001/2003 tax cuts (which are cuts compared to current law), as well as new tax cuts such as the "Making Work Pay Tax Credit." We are more concerned that it is not the time to talk about new tax cuts (or new spending programs) until the fiscal situation is under control.

- Others will say health care does not need to be paid for. The Administration planted an extremely important flag in the ground by saying that any health care expansion should be fully paid for. It will be critically important that they stick to this commitment even as there are pressures to move forward with health care expansion without fully offsetting all the costs. The single most important set of policies in this budget that could help close the long-term fiscal gap are those that focus on slowing the growth of health care costs and they should not be dropped as part of the budget.

The Committee for a Responsible Budget will be releasing a more detailed analysis early next week.