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**Analysis of the President's FY 2011 Budget  
February 3, 2010**

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On Monday, President Obama submitted his budget proposal for FY 2011. The budget proposes \$3.8 trillion in spending and receipts of \$2.6 trillion, resulting in a deficit of \$1.3 trillion – or 8.3 percent of GDP. This is higher than the 7.4 percent deficit projected from the Administration's proposals in its August Mid-Session Review (MSR) and significantly higher than the 6.0 percent deficit projected under their "current law" (BEA) baseline. It is a decrease from the 9.9 percent deficit in FY 2009, and the projected 10.6 percent deficit in FY 2010.

Over the ten year window from 2011 through 2020, deficits are estimated to total \$8.5 trillion – or 4.5 percent of GDP. This is significantly higher the \$5.5 trillion (2.8 percent of GDP) deficit projected under "current law" which assumes expiring policies would end as planned.

The President's budget proposes a fiscal goal of balancing the primary budget so that non-interest spending is equal to revenue by 2015. This will require reducing deficits to roughly 3 percent of GDP. However, the policies included in the budget would only get the deficit down to \$752 billion that year, or 3.9 percent of GDP. The remaining deficit reduction required, nearly 1 percent of GDP or almost \$200 billion, would be closed through recommendations from a fiscal commission.

- CRFB applauds the Administration for setting a fiscal goal – bringing the primary budget into balance by 2015 and stabilizing the debt-to-GDP ratio once the economy recovers.
- However, the budget the President has laid out is far off course from reaching this goal, and we would ideally prefer a more aggressive fiscal goal.
- To help reach their fiscal goal, the Administration's proposals include a number of deficit-reducing policies. The larger ones include: a three year spending freeze of non-security discretionary spending (about \$250 billion in 10-year savings); a cap on itemized deductions (about \$290 billion), and a number of changes to international taxation law (\$122 billion).

- However, the budget also includes a number of proposals that would increase the deficit beyond a current policy baseline, including nearly \$300 billion in tax cuts for families and businesses, \$75 billion in increased funding on Pell Grants and student loans, and nearly \$300 billion in greater “security” discretionary spending.
- More significantly, the Administration assumes the continuation of over \$5 trillion of so-called “current policies,” including over \$3 trillion for the renewal of the 2001/2003 tax cuts (\$678 billion of which they then allow to expire, for those making over \$250,000 a year), nearly \$660 billion for continued AMT patches, about \$370 billion to prevent a 21 percent reduction in Medicare physician payments, and almost \$120 billion to fund Pell Grants at the maximum level set out by the stimulus bill. If it were to maintain current law, in fact, the Administration would exceed its own fiscal goal.
- The Administration proposes creating a fiscal commission to develop the additional deficit reduction measures. We support this commission and encourage policymakers to do so as well. However, given the uncertainty about whether the commission will succeed, we encourage the Administration to have a “back-up plan” to meet the fiscal goal if the commission fails.

Given the dire fiscal situation the country faces, this budget does not go far enough in proposing a realistic deficit and debt reduction plan in either the medium- or long-term. We credit the administration for proposing a fiscal goal, which is the critical first step, and we recognize that offering a budget that is overly specific could backfire, with those policies being rejected by Congress without acceptable alternatives being offered in their place. However, thus far the President has been far more specific about his policies that would increase the deficit than those that would reduce it, and it will require Presidential leadership to focus the national conversation on the types of tax increase and spending cuts that will be necessary to achieve this—or any reasonable—fiscal goal.

## Overview

Under the President’s budget proposal deficits would shrink slowly over much of the next decade, and then would start to grow again. After peaking at \$1.56 trillion (10.6 percent of GDP) in FY 2010, the deficit is projected to drop to \$1.27 trillion (8.3 percent of GDP) in FY 2011, \$828 billion (5.1 percent of GDP) in FY 2012, and \$727 billion (4.2 percent of GDP) in FY 2013. It would begin to grow again in dollar terms in FY 2016 and as a share of GDP in FY 2019. By FY 2020, deficits would again be more than \$1 trillion.

Initially, the deficit falls as a result of economic improvements and a phasing down of stimulus borrowing. This is assisted by the expiration, at the end of 2010, of the 2001/2003 tax cuts for families making over \$250,000 a year, a three-year non-security discretionary spending freeze, the reduction or elimination of a number of tax

preferences, and several other policies. In the later years, these policies keep the deficit at around 4 percent of GDP (although it begins to rise after 2018).

Over ten years, the President's budget would result in deficits of \$8.5 trillion or 4.5 percent of GDP. This is an improvement from OMB's "current policy baseline" number of \$10.6 trillion<sup>1</sup>, but is far worse than their current law (BEA) baseline deficit of \$5.5 trillion, or CBO's current law baseline estimate of \$6.0 trillion.

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

Fiscal Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Ten-Year*
<b>RECEIPTS</b>												
2011 Budget	\$2,165	\$2,567	\$2,926	\$3,188	\$3,455	\$3,634	\$3,887	\$4,094	\$4,299	\$4,507	\$4,710	\$37,268
OMB MSR	\$2,074	\$2,591	\$2,945	\$3,161	\$3,365	\$3,582	\$3,791	\$3,985	\$4,186	\$4,389	n/a	\$34,259
CBO Baseline	\$2,175	\$2,670	\$2,964	\$3,218	\$3,465	\$3,625	\$3,814	\$3,996	\$4,170	\$4,352	\$4,563	\$36,836
<b>OUTLAYS</b>												
2011 Budget	\$3,721	\$3,834	\$3,755	\$3,915	\$4,161	\$4,386	\$4,665	\$4,872	\$5,084	\$5,415	\$5,713	\$45,800
OMB MSR	\$3,653	\$3,715	\$3,741	\$3,936	\$4,143	\$4,321	\$4,586	\$4,795	\$5,001	\$5,307	n/a	\$43,309
CBO Baseline	\$3,524	\$3,650	\$3,613	\$3,756	\$3,940	\$4,105	\$4,335	\$4,521	\$4,712	\$5,000	\$5,250	\$42,883
<b>DEFICIT (dollar)</b>												
2011 Budget	\$1,556	\$1,267	\$828	\$727	\$706	\$752	\$778	\$778	\$785	\$908	\$1,003	\$8,532
OMB MSR	\$1,502	\$1,123	\$796	\$775	\$778	\$739	\$795	\$810	\$815	\$917	n/a	\$9,051
BEA Baseline	\$1,404	\$912	\$613	\$561	\$495	\$492	\$469	\$445	\$421	\$507	\$557	\$5,472
CBO Baseline	\$1,349	\$980	\$647	\$539	\$475	\$480	\$521	\$525	\$542	\$649	\$687	\$6,047
<b>DEFICIT (GDP)</b>												
2011 Budget	10.6%	8.3%	5.1%	4.2%	3.9%	3.9%	3.9%	3.7%	3.6%	3.9%	4.2%	4.5%
OMB MSR	10.4%	7.4%	5.0%	4.6%	4.3%	3.9%	4.0%	3.9%	3.7%	4.0%	n/a	5.1%
BEA Baseline	9.6%	6.0%	3.8%	3.3%	2.7%	2.6%	2.3%	2.1%	1.9%	2.3%	2.3%	2.9%
CBO Baseline	9.2%	6.5%	4.1%	3.2%	2.7%	2.6%	2.7%	2.6%	2.6%	3.0%	3.0%	3.2%
<b>DEBT (dollar)</b>												
2011 Budget	\$9,298	\$10,498	\$11,472	\$12,326	\$13,139	\$13,988	\$14,833	\$15,686	\$16,535	\$17,502	\$18,573	n/a
OMB MSR	\$9,575	\$10,590	\$11,443	\$12,281	\$13,126	\$13,927	\$14,782	\$15,651	\$16,523	\$17,493	n/a	n/a
CBO Baseline	\$8,797	\$9,785	\$10,479	\$11,056	\$11,556	\$12,055	\$12,595	\$13,133	\$13,678	\$14,329	\$15,027	n/a
<b>DEBT (GDP)</b>												
2011 Budget	63.6%	68.6%	70.8%	71.7%	72.2%	72.9%	73.6%	74.2%	74.9%	75.9%	77.2%	n/a
OMB MSR	66.3%	70.0%	71.4%	72.3%	72.9%	73.2%	74.0%	74.7%	75.5%	76.5%	n/a	n/a
CBO Baseline	60.3%	65.3%	66.6%	66.3%	65.6%	65.4%	65.5%	65.5%	65.7%	66.1%	66.7%	n/a

\*Ten-Year column in Receipts and Outlays shows FY2011-2020 for the Budget and CBO baseline, but 2010-2019 for the OMB Midsession Review.

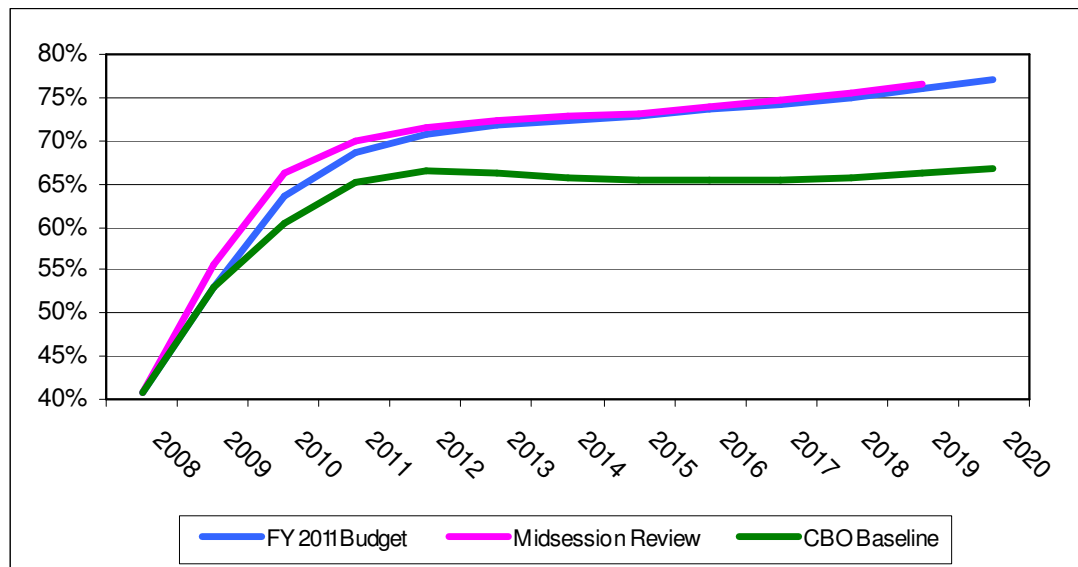
<sup>1</sup> The President's current policy baseline differs from a current law baseline in that it assumes the continuation of the 2001 and 2003 tax cuts after their expiration at the end of 2010, it accounts for expected Medicare physician payment updates, it covers continued AMT patches, and it assumes Pell grants are funded at the levels put forward under the stimulus bill.

Under the budget, revenues would average 18.9 percent of GDP and reach 19.6 percent of GDP by 2020. This is somewhat higher than historical averages of about 18.1 percent since 1970, but is lower than current law revenue levels of 20.2 percent of GDP in 2020, according to the CBO. More importantly, these revenue levels are significantly lower than projected outlays.

Over the next decade, outlays are projected to average around 23.3 percent of GDP, and reach 23.7 percent of GDP by 2020. This is significantly higher than historical averages of roughly 20.7 percent (since 1970) and particularly troublesome since outlays would grow further beyond 2020 as Social Security, Medicare, and Medicaid costs continue to rise.

As a result of the disconnect between taxes and spending, under the President's budget, debt held by the public will rise from 53 percent of GDP at the end of FY 2009 to 71 percent by 2012, and 77 percent by 2020. This level of debt is significantly higher than under current law, where debt is expected to reach 67 percent of GDP by 2020, according to the CBO. Our preference, as laid out in the Peterson-Pew Commission report, "Red Ink Rising," would be to stabilize the debt at 60 percent of GDP by 2018; this budget hits 75 percent that year and keeps rising.

**Fig. 2: Public Debt as a percent of GDP, 2008 – 2020**



The budget does not reach the Administration's stated fiscal goal of balancing the primary (non-interest) budget by 2015, or of stabilizing the debt after the economy fully recovers. Acknowledging this, the Administration proposes establishing a bipartisan fiscal commission charged with proposing policies to balance the primary budget and examine policies to "meaningfully improve the long-term outlook." Although the necessary magnitude of commission-proposed deficit reduction is subject to uncertainty, it would likely be about one percent of GDP – or nearly \$200 billion – for 2015 alone.

As we have noted, if no changes were made to the current law budgetary track, the deficit would be 2.6 percent of GDP in 2015—below the goal the President has suggested. Perhaps the President should threaten not to extend any of the 2001/2003 tax cuts—the largest contributor to the deficit increases under his budget—unless the fiscal commission recommendations, or equivalent deficit-reducing legislation, are enacted.

## Discretionary Spending

In their budget, the Administration is proposing a 3-year “non-security” discretionary spending freeze, beginning in FY 2011. Relative to its baseline, which assumes discretionary spending grows with inflation, this would save \$249 over ten years.

While we commend the Administration for taking this small step towards fiscally responsible budgeting, we—and they—recognize the practical impact of this freeze is that it will not do nearly enough on its own to bring down medium-term deficits. The freeze applies to less than 13 percent of federal spending. And the “security” side of the budget – other than war spending – is proposed to cost \$284 billion more than under their baseline; these costs more than offset the savings from the discretionary freeze.

To improve this freeze, we believe it should be enforced through statutory discretionary spending caps. These caps should also be extended to the remainder of discretionary spending—either through separate security and non-security caps, or as a single discretionary cap. Defense, homeland security, international affairs, and veterans spending suffer from many of the same excesses as the non-security side, and must also be controlled. We were heartened to hear the President back up his proposed freeze with a veto threat in the State of the Union.

It is important to note that the Administration’s freeze would be applied at the global rather than agency level. In other words, some areas of the non-security budget could receive increased funding, as long as this was offset by cuts in other areas.

To help control discretionary spending and maintain this non-security freeze, the Administration has put forth a list of 78 proposed cuts and terminations; totaling \$10.3 billion in FY 2011 (they have also included 33 mandatory programs saving \$11.1 billion). Among the largest of these cuts, the Administration proposes canceling the Constellation Systems Programs which was intended to send astronauts to the Moon and then Mars (\$3.5 billion), and halting production of the C-17 Transport Aircraft (\$2.5 billion).

Last year, the President saw significant success in getting his proposed cuts enacted. Congress fully accepted about one-third of his cuts and partially accepted another twenty percent; in dollar terms, about two thirds of his proposed cuts were enacted. We

worry, though, that it will not be as easy this year. More than one-third of his proposed cuts are repeats from last year – and have thus already been rejected (that includes the C-17). Moreover, there are very few “big ticket” items in this year’s list. Still, we are hopeful that the President’s insistence on a spending freeze will force Congress to look very carefully at cutting many of these wasteful and redundant programs.

## Policy Proposals

This year’s budget puts forward a significant number of new policy proposals. The budget estimates that the proposals would save \$2.1 trillion over ten years relative to its “current policy” baseline, but *cost* \$3.1 trillion relative to a current law baseline.

The disparity is the result of a large number of policies the President assumes in his baseline, which are not, in fact, consistent with current law. In particular, he assumes continued patching of the AMT, the renewal of all the 2001/2003 tax cuts (though he then allows the upper income cuts to expire), the updating of Medicare physician payments, the continuation of Pell Grant funding based on levels instituted in the stimulus bill, and other smaller changes – adding a total of \$5.2 trillion to the deficit over the next decade.

On the tax side, the President has proposed \$378 billion of new tax cuts over ten years, in addition to the “current policy” tax cuts described. Among the larger cuts are an extension of the American Opportunity Tax Credit for college (\$75 billion) and the research & experimentation tax credit (\$83 billion), an expansion of the earned income tax credit (\$15 billion), and a one-year continuation of the Making Work Pay tax credit (\$61 billion). This excludes the Administration’s plan to extend most of the 2001/2003 tax cuts; including the extension of the supposedly temporary child tax credit and EITC expansions from the 2009 stimulus which could cost up to \$100 billion.

Meanwhile, the budget calls for \$1.4 trillion in tax increases over ten years – or about \$760 billion, not counting the allowed expiration of the 2001/2003 tax cuts for wealthier families at the end of 2010. Among the larger revenue-raisers includes a “financial crisis” fee on banks to pay back TARP funds (\$90 billion), a limit to itemized deductions so individuals cannot deduct beyond 28% of income (\$291 billion), a number of measures aimed at closing the “tax gap” (\$49 billion), and around a dozen policies designed to reform international taxation (\$122 billion).

On the spending side, increases total \$559 billion over ten years. These include increasing “security” discretionary spending (\$284 billion over ten years), instituting reforms to the financial regulatory system (\$20 billion), increasing funding for college grants and loans (\$76 billion), and enacting or extending a number of stimulus measures such as unemployment benefits and Medicaid payments to the states (\$84 billion).

Spending cuts are roughly \$1.3 trillion; however they would shrink to about \$620 billion without including the savings from war costs, which should naturally decline as war efforts in Iraq and Afghanistan wind down. Among the larger cuts include \$249 billion from the discretionary spending freeze, \$132 billion from program integrity efforts to reduce waste, fraud, and abuse, \$49 billion from student loan reform, and an assumed \$150 billion in savings from health care reform legislation—which assumes savings equal to the average between the House and Senate bills.

**Fig. 3: Tax Proposals, Spending Proposals, and their Effects on the Deficit**

			FY2011-2015		2011-2020		
“Current Law” Baseline			-\$3,073		-\$5,472		
			FY2011-2015		2011-2020		
AMT Patch			-\$233		-\$659		
2001/2003 Tax Cuts			-\$1,251		-\$3,097		
Medicare Physician Payment Updates			-\$150		-\$371		
Pell Grants Increase			-\$56		-\$118		
Other			-\$7		-\$14		
Debt Service			-\$167		-\$909		
“Current Policy” Adjustments			-\$1,864		-\$5,168		
Tax Proposals		2011-2015	2011-2020	Spending Proposals		2011-2015	2011-2020
Stimulus Measures*		-\$95	-\$85	Stimulus Measures*		-\$84	-\$84
American Opportunity Tax Credit		-\$31	-\$75	Discretionary "Security" Increases		-\$109	-\$284
Permanent R & E tax Credit		-\$33	-\$83	Higher Education Funding		-\$21	-\$76
Tax Incentives for Savings		-\$15	-\$40	Financial System Regulatory Reform		-\$10	-\$20
Other Tax Cuts		-\$58	-\$95	Other Spending Increases		-\$53	-\$95
Total Tax Cuts		-\$233	-\$378	Total Spending Increases		-\$277	-\$559
Banking Fee for TARP		\$43	\$90	Health Reform Legislation		\$127	\$150
International Tax System Reform		\$58	\$122	Reduced War Spending		\$250	\$728
Reduction of Tax Gap		\$17	\$49	Non-Security Discretionary Freeze		\$105	\$249
Expiration of Upper-Income Tax Cuts		\$252	\$678	Student Loan Reform		\$28	\$49
Limits to Itemized Deductions		\$110	\$291	Reduction of Waste, Fraud, and Abuse*		\$36	\$132
Loophole Closers and Other Changes		\$107	\$207	Other Mandatory Savings		\$16	\$36
Total Tax Increase		\$587	\$1,437	Total Spending Cuts		\$562	\$1,344
Net Tax Increase from Current Policy		\$353	\$1,059	Net Spending Cut from Current Policy		\$285	\$785
				2011-2015		2011-2020	
BEA Baseline Deficit				-\$3,073		-\$5,472	
Current Policy Adjustments				-\$1,864		-\$5,168	
Net Tax Increase from Current Policy				\$353		\$1,059	
Net Spending Cut from Current Policy				\$285		\$785	
Net Interest Savings from Current Policy				\$18		\$266	
Total Deficit				-\$4,280		-\$8,531	

Note: positive numbers represent reduction in the deficit

\*includes \$76 billion in unspecified allowances for job creation, split evenly between taxes and spending.

\*not scoreable for PAYGO purposes

As debt levels increase, so too do the interest costs of servicing that debt. Under the President's budget, interest payments are expected to increase from \$188 billion (1.3 percent of GDP) in 2010, to \$840 (3.5 percent of GDP) in 2020. That means that by the end of the decade, interest on the debt will consume 15 percent of the entire budget – up from only 5 percent this year. These estimates are highly sensitive to interest rates, and costs could be significantly higher if rates rise above what is assumed.

## Economic Assumptions

The Administration's economic assumptions play a significant role in their budget outlook. Small differences in GDP growth, unemployment, inflation and interest rate assumptions can impact deficit estimates by hundreds of billions over a ten-year period.

The Administration economic assumptions, this year, seem more conservative than last year's budget, for the most part. OMB projects that annual real GDP growth will turn positive in 2010 (2.7 percent), and estimates a growth rate similar to the latest Blue Chip Consensus forecast (2.8 percent). The Administration's forecast is well above the latest CBO forecast of 2.2 percent because the Administration assumes that additional stimulus will be adopted by Congress this year (around \$100 billion) and CBO's estimates do not include any assumptions about additional stimulus legislation.

**Fig. 4: Economic Assumptions (Calendar year)**

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Real GDP												
FY 2011 Budget	-2.5%	2.7%	3.8%	4.3%	4.2%	4.0%	3.6%	3.2%	2.8%	2.6%	2.5%	2.5%
Midsession Review	-2.8%	2.0%	3.8%	4.3%	4.3%	4.1%	3.6%	3.2%	2.8%	2.6%	2.5%	n/a
CBO Baseline	-2.5%	2.2%	1.9%	4.6%	4.8%	3.9%	2.9%	2.5%	2.3%	2.2%	2.2%	2.3%
Blue Chip Consensus	-2.5%	2.8%	3.1%	n/a								
CPI-U												
FY 2011 Budget	-0.3%	1.9%	1.5%	2.0%	2.0%	2.0%	2.0%	2.0%	2.1%	2.1%	2.1%	2.1%
Midsession Review	-0.7%	1.4%	1.5%	1.9%	2.0%	2.0%	2.0%	2.1%	2.1%	2.1%	2.1%	n/a
CBO Baseline	-0.2%	2.4%	1.3%	1.2%	1.1%	1.3%	1.7%	1.9%	2.0%	2.0%	2.0%	2.0%
Blue Chip Consensus	-0.4%	2.1%	2.0%	n/a								
Unemployment												
FY 2011 Budget	9.3%	10.0%	9.2%	8.2%	7.3%	6.5%	5.9%	5.5%	5.3%	5.2%	5.2%	5.2%
Midsession Review	9.3%	9.8%	8.6%	7.7%	6.8%	5.9%	5.6%	5.5%	5.3%	5.3%	5.2%	n/a
CBO Baseline	9.3%	10.1%	9.5%	8.0%	6.3%	5.3%	5.1%	5.0%	5.0%	5.0%	5.0%	5.0%
Blue Chip Consensus	9.3%	10.0%	9.2%	n/a								

On the employment outlook, the budget assumes unemployment to remain above 10 percent for most of 2010, but eventually fall below the 10 percent threshold. It assumes some improvement in the unemployment rate in 2011 (9.2 percent on average) and

stronger improvement in subsequent years (7.3 percent in 2013, with full employment reached in 2014). These estimates are similar to the Blue Chip forecasts but more optimistic than CBO in the early years. In the later years, OMB's estimates are somewhat more pessimistic than CBO, as the Administration appears to have a higher estimate of full employment (5.2 percent as opposed to 5 percent). The budget projects that inflation will remain relatively low over the next decade, at about 2 percent. This is just a bit higher than CBO's assumption.

## Conclusion

Congress and the White House must begin the process of closing the fiscal gap. We are pleased to see President Obama laying out an important fiscal marker for deficit reduction. Although the Administration's fiscal goal differs from that of the Peterson-Pew Commission on Budget Reform's (stabilizing the debt at 60 percent of GDP by 2018), the fact that it laid out a specific marker is extremely helpful in both getting deficits and debt under control and forcing a discussion about the tradeoffs involved.

On the policy, the budget includes some good first steps, including the non-security discretionary spending freeze, and a number of other policies on the tax side designed to reduce the deficit. It also includes a number of policies, however, which add to the deficit. In sum, their policies are far from sufficient to reach their fiscal goal—a goal we already worry is not aggressive enough in the medium term and way too vague in the longer-term.

While we are supportive of the establishment of a fiscal commission to make up the difference, we would encourage the Administration to have a back-up plan in case the commission fails to do so. We encourage members of both parties to lend their support to a commission to help tackle the nation's medium- and long-term fiscal imbalances.

We also believe that, since some of the President's proposed tax increases and spending cuts – many of which are hold-overs from last year – may be no more successful than they were last year, the President should be flexible to alternate ideas to reduce the deficit, and should work with Congress to formulate and enact deficit-reduction policies.

This will be an important year in the budget. The fiscal commission, the scheduled expiration of the 2001/2003 tax cuts, and the growing public pressure to bring the debt under control should all provide opportunities to make significant inroads in stabilizing the national debt. In its current form, the President's budget does not do this, and in fact increases the deficit and debt significantly relative to current law.

Neither Congress nor the President should miss this opportunity and responsibility to make a real difference in the nation's fiscal future. The path we are on is clearly unsustainable.