Committee for a Responsible Federal Budget

Analysis of the President's FY 2013 Budget
February 16, 2012

On Monday, the White House released its FY 2013 budget. Our major findings include:

- Debt held by the public would rise from **68 percent** of GDP in 2011 to **74 percent** in 2012 and **77 percent** in 2013, before declining to over **76 percent** in 2018 and stabilizing at that level through 2022. We estimate that under CBO's more pessimistic economic assumptions, debt would reach nearly **80 percent** of GDP in 2022.

- The budget proposes **$2.1 trillion** in new gross revenues through 2022 relative to current policy, along with **$360 billion** in health care reductions, and **$160 billion** in other mandatory reductions.

- The President's budget also proposes a number of *deficit-increasing* measures, including a **$350 billion** jobs package, nearly **$370 billion** in tax reductions, and nearly **$270 billion** in increased spending – mostly for education and infrastructure.

- When combined with the Budget Control Act (BCA) discretionary caps, the drawdown of the wars in Iraq and Afghanistan, and the recovering economy, these proposals would lift revenue from **15.8 percent** of GDP in 2012 to **20.1 percent** in 2022 while reducing spending from **24.3 percent** of GDP in 2012 to **22.8 percent** by 2022.

- Under the budget, deficits would fall from **8.5 percent** of GDP in 2012 to **5.5 percent** in 2013, **3.0 percent** in 2017, and roughly **2.8 percent** annually between 2018 and 2022.

- The President's budget takes an important step by laying out a number of policies to stabilize the debt. Given how serious the nation's fiscal challenges are, however, the President should have laid out a specific comprehensive plan to return the nation to a sustainable fiscal path, rather than just a first step.

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Overview

The FY 2013 budget shows deficits of more than $1.3 trillion (8.5 percent of GDP) in 2012 and about $900 billion (5.5 percent of GDP) in 2013. After 2013, these deficits will continue to fall as a share of the economy – to 3.9 percent in 2014 ($668 billion), 3.0 percent in 2017 ($612 billion), and about 2.8 percent of GDP per year thereafter, through 2022.

Due to a combination of the economic recovery, the unwinding of certain stimulus tax cuts, the implementation of revenue provisions from the 2010 health reform legislation, and the President's revenue-raising policies, revenues under the President's budget would rise from 15.8 percent of GDP in 2012 to 19.0 percent by 2015 and 20.1 percent by 2022.

As the economy recovers, stimulus expires, the war draws down, and proposed spending cuts are implemented, outlays would fall – from 24.3 percent of GDP in 2012 to 23.3 percent in 2013 and 22.0 percent by 2017. However, due to population aging and rising health care costs outlays will rise after 2017, reaching 22.8 percent by 2022.

Fig. 1: Revenue, Outlays, Deficit, and Debt under the President's Budget (Percent of GDP)

Fiscal Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Ten-Year
Revenue												
FY2013 Budget	15.8%	17.8%	18.7%	19.0%	19.1%	19.2%	19.4%	19.5%	19.7%	19.9%	20.1%	19.2%
2012 Submission*	15.0%	17.5%	19.5%	19.5%	19.0%	19.5%	19.5%	19.5%	19.5%	19.5%	N/A	19.0%
FY2012 Budget (CBO)	16.2%	17.7%	18.6%	18.9%	19.0%	19.1%	19.1%	19.1%	19.2%	19.3%	N/A	18.7%
Outlays												
FY2013 Budget	24.3%	23.3%	22.6%	22.3%	22.5%	22.2%	22.0%	22.3%	22.5%	22.7%	22.8%	22.5%
2012 Submission*	24.0%	23.0%	22.0%	21.5%	21.5%	22.0%	22.0%	22.0%	22.5%	22.5%	N/A	22.0%
FY2012 Budget (CBO)	23.6%	23.2%	23.0%	23.0%	23.4%	23.4%	23.4%	23.8%	24.0%	24.2%	N/A	23.5%
Deficit												
FY2013 Budget	8.5%	5.5%	3.9%	3.4%	3.0%	2.7%	2.8%	2.8%	2.8%	2.8%	2.8%	3.3%
2012 Submission	8.5%	5.1%	2.7%	2.9%	3.0%	2.5%	2.2%	2.3%	2.4%	2.3%	N/A	3.4%
FY2012 Budget (CBO)	7.4%	5.5%	4.4%	4.1%	4.4%	4.3%	4.3%	4.7%	4.8%	4.9%	N/A	4.8%
Debt												
FY2013 Budget	74.2%	77.4%	78.4%	78.1%	77.8%	77.1%	76.5%	76.4%	76.5%	76.5%	76.5%	N/A
2012 Submission	73.5%	77.5%	77.2%	75.2%	74.5%	74.0%	73.6%	73.6%	73.7%	74.0%	N/A	N/A
FY2012 Budget (CBO)	74.3%	77.2%	78.3%	78.9%	79.9%	81.1%	82.4%	84.0%	85.7%	87.4%	N/A	N/A

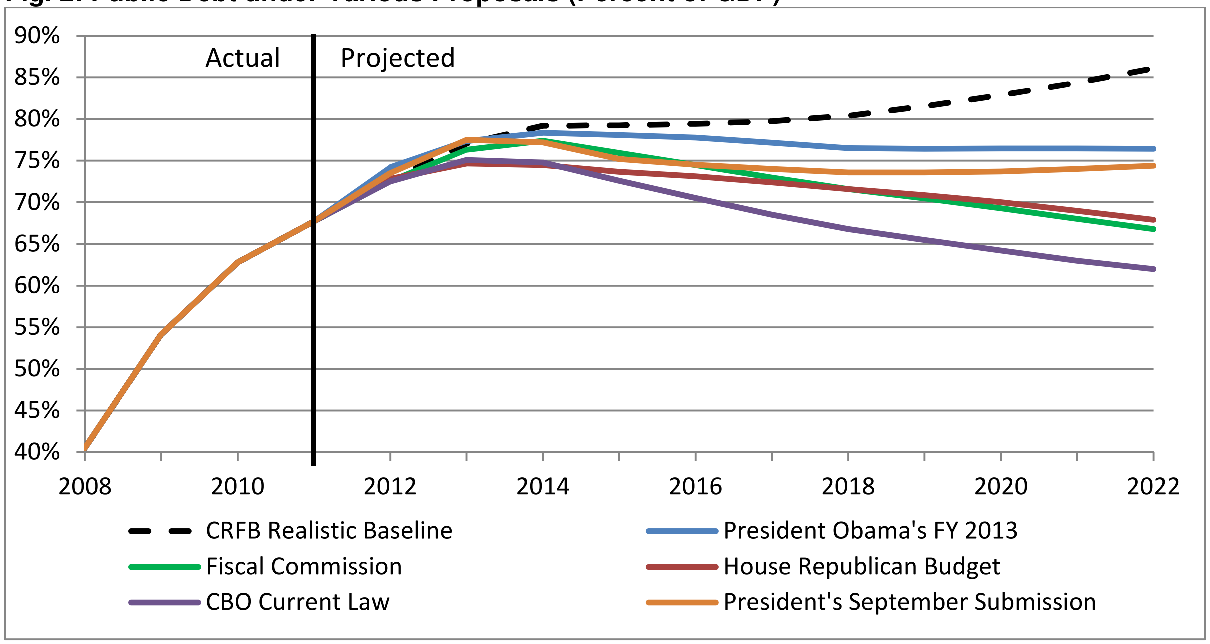
* Estimates for the President's submission rounded to nearest 0.5 percent.

Debt

As a result of these deficits, debt in the President's budget would rise in early years – from less than 68 percent of GDP in 2011 to over 78 percent in 2014. Beyond 2014, debt would begin to shrink relative to the economy and ultimately stabilize at over 76 percent of GDP through 2022. Importantly, this is a major improvement over last year's budget – in which debt rose to 87 percent of GDP by 2021. Though much of the difference is due to the spending caps passed under the Budget Control Act, this year's budget also includes a substantial amount of new deficit reduction relative to last year's in all areas of the budget including revenue, health care, and other mandatory savings.

That said, the President's most recent budget falls short when compared to other debt reduction plans that have been put forward, including from the President himself in September 2011 (which projected debt levels of 74 percent of GDP in 2021). Both the Fiscal Commission's plan and the budget passed by House Republicans last year would put debt on a clear downward path, whereas the President's budget only temporarily stabilizes the debt.

Fig. 2: Public Debt under Various Proposals (Percent of GDP)



Note: For more details on the CRFB Realistic Baseline, see http://crfb.org/document/analysis-cbos-budget-and-economic-projections-and-crfbs-realistic-baseline. Estimates for House Republican Budget based on older estimates, and include the costs of annual doc fixes.

Over the long-term, the President's budget would not constrain rising debt, as retirement and health care costs continue growing faster than the economy. According to the Administration's own estimates, debt would grow as a share of the economy past 2022 – exceeding 93 percent by 2035 and nearly 125 percent by 2050. These levels would be both economically constraining and ultimately unsustainable.

Jobs Proposals

President Obama's budget includes a number of measures that are intended to boost short-term economic growth, particularly in 2012 and 2013. Taken together, these proposals would cost $178 billion in 2012 alone and more than $350 billion through 2022.

On the tax side, he would extend the two percent payroll tax holiday for the remainder of the year, extend 100 percent expensing for businesses on certain equipment, provide a temporary employer tax credit for creating jobs or increasing wages, and enact a number of smaller changes. On the spending side, the President would extend and reform expanded unemployment benefits and increase infrastructure investment for schools, highways, and other areas. The budget would also provide small amounts of spending for additional job creation initiatives.

Box 1: Does the President's Budget Reduce the Deficit by $4 trillion?

Ever since the President's Fiscal Commission (Simpson-Bowles) presented a plan to reduce the deficit by $4 trillion over a decade, this $4 trillion number has become a de-facto minimum benchmark for a fiscally responsible plan. To meet this benchmark last April, the President presented his own deficit reduction plan, which he claimed would save $4 trillion – but over twelve years instead of ten.[1]

In this year's budget, the President again claims that he is calling for $4 trillion in cumulative savings; the budget states that "together with the deficit reduction I signed into law this past year, this Budget will cut the deficit by $4 trillion over the next decade."[2] Specifically, the President claims that the budget would save $4.3 trillion through 2021 and $5.3 trillion through 2022.

So would the President's budget actually achieve $4 trillion in new savings? Well, the answer depends on what savings are compared against, and what is counted as savings – but in no case does the President have comparable deficit reduction to the Fiscal Commission. To reach his $4.3 trillion in savings through 2021, the President's budget counts $1.6 trillion (excluding interest) of already-enacted savings. In addition, it includes two elements which the Fiscal Commission assumed in its baseline – a drawdown of the wars ($740 billion through 2021) and the expiration of the upper-income tax cuts ($830 billion through 2021). If the Commission's plan were scored the same way as the President's $4.3 trillion, we estimate it would save roughly $6.5 trillion through 2021.

In short, the President's budget falls well short of the $4 trillion in savings claimed by the Fiscal Commission – but how much would it save? That depends on the baseline, of course. Compared to CRFB's Realistic Baseline (see Box 2), we estimate that all new policies in the President's budget would save nearly $2 trillion through 2022. Relative to CBO's current law baseline, on the other hand, it would *increase* deficits by more than $4.2 trillion (see Fig. 4 for more details).

[1] See CRFB's analysis of the President's April Framework, http://crfb.org/document/analyzing-presidents-new-budget-framework
[2] President's FY 2013 Budget, pp. 2-3.

Discretionary Spending

By and large, the President's discretionary levels track those agreed to in the BCA. Based on those caps, FY2013 base discretionary savings is limited to $1.047 trillion – $4 billion more than the FY 2012 discretionary cap (the Administration adjusts that number down to $1.043 trillion to account for a change in budgetary treatment for highways).

Defense spending in the President's budget would be reduced by 1 percent in 2013. Funding for the Justice Department, Department of Homeland Security, and the EPA would also see cuts. On the other hand, the President would increase spending for research and development throughout government – particularly for clean energy programs, biomedical research, the National Science Foundation, and programs for advanced manufacturers.

Although the President's budget holds non-war discretionary spending to levels as specified by the BCA, the Administration does make two changes within the discretionary budget. First, the Administration calls for a cap on war spending – and counts the $850 billion in lower spending (compared to a baseline that has war spending growing at the rate of inflation) toward his savings totals. As CRFB has written before, a war spending cap can help ensure defense savings materialize, but counting savings from the war drawdown is nothing more than a budget gimmick. This change does not represent a new policy, but rather a recognition of a policy already in place.

Even more concerning is that the President proposes to use some of these phony war savings in order to finance an increase in highway spending. Currently, Congress is negotiating a highway bill to fund future transportation infrastructure. Existing gas tax revenue is insufficient to cover current highway spending levels, meaning that policymakers must identify new offsets to cover their costs. The Administration's proposal, however, would circumvent this process by simply using phony war savings in order to cover the existing shortfall *and* to increase transportation spending by $125 billion.

Mandatory Spending

President Obama borrows from his September Submission to the Super Committee to make a substantial number of reductions and reforms to mandatory spending programs.

On the health side, the largest amount of savings – over $150 billion through 2022 – would come from a policy to require certain drug manufacturers in Medicare Part D to pay rebates to the government. The President also supports over $100 billion in various reductions in provider payments to hospitals and post-acute care facilities as well as over $30 billion in Medicare beneficiary changes beginning after 2017 (the largest of which is an increase in premiums for higher earners). In addition, the President supports about $50 billion in Medicaid savings – mainly from reducing gaming of the matching rate by states and switching to a single "blended rate" for each state – along with a number of smaller health savings.

Outside of health care, the President supports eliminating direct payments to farmers and making other agricultural subsidy reforms (over $30 billion in savings); reforming the federal civilian retirement program, including by increasing employee contributions (about $30 billion in savings); and putting in place or increasing a variety of user fees and asset sales ($75 billion in savings); along with a variety of smaller spending cuts.

Box 2: What's in a Baseline?

Each year, the Administration puts together two baselines, one as mandated by the Budget Enforcement Act of 1990 to reflect a "current law" path for future spending and revenues and another "adjusted baseline" used to typically craft a more realistic assessment of future policies.

In this year's budget proposal, however, the Administration's current law path differs significantly from CBO's assumptions, namely from not including the savings from the BCA discretionary caps and the sequester set to go off in January 2013. Additionally, the Administration's adjusted baseline differs from other projections of "current policy," or more realistic assumptions, going forward in that the sequester stays in place and war costs continue to grow – which makes the budget appear to "save" money by drawing down the wars when that's been a policy in place for some time now.

Fig. 3: Assumptions Incorporated in Various Baselines

	OMB BEA Baseline	OMB Adjusted Baseline*	CBO Current Law	CRFB Realistic
2001/2003/2010 Tax Cuts	Expire	Continue	Expire	Continue
AMT Patches	Expire	Continue	Expire	Continue
Discretionary Growth	Inflation	BCA Caps	BCA Caps	BCA Caps
$1.2 Trillion Sequester	Repealed	In Effect	In Effect	Repealed
War Spending Growth	Inflation	Inflation	Inflation	Drawdown
Doc Fixes	Expire	Continue	Expire	Continue
Deficit in 2022 (% GDP)	*1.9%*	*4.7%*	*1.4%*	*5.0%*
Debt in 2022 (% GDP)	*67%*	*83%*	*62%*	*86%*

*OMB Adjusted Baseline also assumes Pell Grants funded at maximum level and makes adjustments for disaster costs.

In addition to these cuts, the President's budget includes a number of spending *increases*. His baseline assumes $438 billion in costs from enacting a permanent "doc fix" to prevent a 27 percent cut in Medicare physician payments, along with $50 billion in Pell Grants funding to maintain current award levels. The President also includes a number of new mandatory policies, the largest being a $35 billion universal dislocated worker program.

Tax Policy

In his budget, President Obama calls for comprehensive tax reform meant to achieve a number of principles. Specifically, he calls on tax reform to simplify the code, lower tax rates, reduce the number of tax brackets, eliminate tax breaks for millionaires, and reduce and simplify tax breaks so they offer "at least as good a deal for the middle class as for wealthy Americans." He also calls for tax reform that would reduce the deficit by at least $1.5 trillion in a way that is at least as progressive as if the upper-income tax cuts expired, would increase domestic job creation and growth, and would observe a "Buffett Rule," requiring that households making over $1 million pay at least 30 percent of income in taxes.

Fig. 4: Effect of Tax and Spending Proposals on the Deficit (Billions)

	2012-2022
Current Law Baseline	**-$3,770**
Assume Renewal of Tax Cuts	-$4,525 billion
Assume "Doc Fixes"	-$440 billion
Assume Sequester Repeal	-$965 billion
Drawdown War Spending	$850 billion
Interest Costs	-$1,060
Current Policy Baseline	**-$9,910**
Jobs Initiatives	**-$355 billion**
Tax Reductions	-$140 billion
Spending Increases	-$215 billion
Revenue Proposals	**$1,735 billion**
Allow 2001/2003 Tax Cuts to Expire for Income Above $250,000	$970 billion
Limit Tax Expenditures for Higher Earners	$585 billion
Reduce Corporate Tax Preferences	$310 billion
*Other Revenue Increases**	$240 billion
Manufacturing and "Insourcing" Incentives	-$125 billion
Other Tax Reductions	-$245 billion
Spending Proposals	**$230 billion**
Require Drug Rebates for Medicare Part D	$155 billion
Reduce Medicare Provider Payments (Including Interactions)	$105 billion
Reduce and Reform Medicare Benefit for Beneficiaries	$30 billion
Reduce Medicaid Costs	$50 billion
Reduce Other Health Spending	$20 billion
Reduce Farm Subsidies	$30 billion
Increase User Fees and Sell Assets	$75 billion
Reform Federal Retirement	$25 billion
*Other Spending Cuts^*	$25 billion
Increase Transportation Spending	-$125 billion
Other Spending Increases	-$140 billion
Net Interest	**$240 billion**
TOTAL DEFICITS^	**$8,010 billion**
Deficit Reduction Relative to Current Law	**-$4,240 billion**
Deficit Reduction Relative to Current Policy	**$1,900 billion**
Deficit Reduction Relative to OMB Adjusted Baseline	**-$1.780 billion**

Note: Positives/negatives reflect deficit decreases/increases, respectively. Numbers are rounded.
*Includes revenues from financial transaction tax, IRS anti-fraud spending, and changes to the UI tax base, which the Administration claims as spending proposals.
^Other spending cuts exclude $44 billion timing shift in 2022, whereas total deficits include the timing shift to match OMB's deficit projections.

To move toward (but not achieve) these goals, the President's budget offers a number of policies meant to raise revenue in a progressive manner. Most significantly, the President would allow the 2001/2003/2010 income and estate tax cuts to expire for higher earning individuals (generally, households making above $250,000 a year), which would raise nearly $970 billion compared to the $4.5 trillion in costs of extending all of the tax cuts. However, relative to current law – assuming the middle-income tax cuts are renewed and the AMT continues to be "patched" – this policy would *increase* deficits by more than $3.5 trillion.

To further reduce the deficit, the President proposes additional revenue increases from higher earning individuals and corporations. On the individual side, most of the remaining revenue (about $580 billion in savings) comes from a policy that would limit the value of various tax deductions and exclusions for those in the highest tax brackets.

On the corporate side, the President's budget includes a variety of revenue-raising policies, including from reforming the U.S. international tax system (about $150 billion in savings), reducing tax benefits for financial, insurance, and fossil fuel industries (about $50 billion in savings), and enacting a variety of other changes.

The President also includes several revenue-generating policies in his set of mandatory proposals, including by increasing IRS enforcement, reforming the unemployment insurance tax, and establishing a tax on banks to recover the costs of the TARP program.

At the same time, the President proposes a number of tax *cuts*. For individuals, the largest cut would be an extension of the American Opportunity Tax Credit for college attendance. On the corporate side, the President's budget includes a number of policies to expand manufacturing and encourage "insourcing," including by making the research and experimentation tax credit permanent.

On net, these policies together would generate about **$1.7 trillion** in deficit reduction relative to current policy.

Economic Assumptions

An important part of any budget is the economic assumptions that underlie them. The stronger the economy, the more revenue that will be collected and the greater the capacity to maintain higher levels of nominal debt.

OMB's economic assumptions are somewhat more optimistic than CBO's, as well as the Blue Chip consensus ranges. The Administration projects real GDP growth to be 2.7 percent in 2012 and 3.0 percent in 2013, compared to 2.2 percent and 1 percent, respectively, from the CBO. Importantly, much of this difference is due to the fact that CBO assumes a temporary economic contraction in 2013 due to all the tax cuts expiring and the automatic spending sequester going off at the same time in the start of 2013. However, OMB continues to be more optimistic than CBO beyond this contractionary period, with estimated growth rates of 2.5 percent per year by the end of the decade as opposed to 2.4 percent by CBO.

On the whole, these faster growth rates likely lead to a more favorable fiscal picture than what CBO would show using its economic projections. By our estimates, if OMB were to employ CBO assumptions debt would stabilize at about 80 percent of GDP as opposed to 76 percent.

Fig. 5: Comparison of Economic Projections (Calendar Year)

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	10-Year
Real GDP Growth												
FY 2013 Budget	2.7%	3.0%	3.6%	4.1%	4.0%	3.9%	3.2%	2.7%	2.5%	2.5%	2.5%	3.2%
CBO Outlook	2.2%	1.0%	3.6%	4.9%	4.2%	3.3%	2.8%	2.6%	2.5%	2.4%	2.4%	2.9%
Mid-Session Review	3.3%	3.7%	4.0%	3.9%	3.7%	3.2%	2.7%	2.5%	2.5%	2.5%	N/A	2.5%
Blue Chip Average	2.3%	2.8%	N/A									
Inflation Growth												
FY 2013 Budget	2.2%	1.9%	2.0%	2.0%	2.1%	2.1%	2.1%	2.1%	2.1%	2.1%	2.1%	2.1%
CBO Outlook	1.7%	1.5%	1.5%	1.7%	2.0%	2.2%	2.3%	2.3%	2.3%	2.3%	2.3%	2.0%
Mid-Session Review	1.9%	1.9%	2.0%	2.0%	2.1%	2.1%	2.1%	2.1%	2.1%	2.1%	N/A	2.0%
Blue Chip Average	2.0%	2.2%	N/A									
Unemployment												
FY 2013 Budget	8.9%	8.6%	8.1%	7.3%	6.5%	5.8%	5.5%	5.4%	5.4%	5.4%	5.4%	6.6%
CBO Outlook	8.8%	9.1%	8.7%	7.4%	6.3%	5.7%	5.5%	5.5%	5.4%	5.4%	5.3%	6.7%
Mid-Session Review	8.3%	7.7%	6.9%	6.3%	5.7%	5.3%	5.2%	5.2%	5.2%	5.2%	N/A	6.1%
Blue Chip Average	8.5%	8.0%	N/A									
Gross Domestic Product (Fiscal Year, Trillions)												
FY 2013 Budget	$15.8	$16.5	$17.4	$18.4	$19.5	$20.7	$21.7	$22.7	$23.7	$24.7	$25.8	N/A
CBO Outlook	$15.6	$16.0	$16.8	$17.9	$19.0	$19.9	$20.9	$21.9	$22.9	$23.9	$24.9	N/A
Mid-Session Review	$16.0	$16.9	$17.9	$18.9	$19.9	$20.9	$21.9	$22.8	$23.8	$24.8	N/A	N/A

Conclusion

The President's budget tracks closely to his submission to the Super Committee in September, which was a step in the right direction on deficit reduction, but not nearly sufficient. The President's budget would stabilize the debt as a share of the economy through the second half of the decade, but would do so at too high of a level and without the necessary entitlement reforms to bring down the debt over the long-run.

Rather than offer savings large enough to fix the budget problem, the Administration attempts to inflate its headline savings number, as can be seen by looking at the more important metric of debt as a share of GDP. It is highly disappointing that the President didn't go further in his proposals and offer a plan that is large enough to deal with the nation's fiscal challenges in the medium and long-term.