COMMITTEE FOR A RESPONSIBLE FEDERAL BUDGET

Analysis of the President's FY 2015 Budget
March 4, 2014

Today, the President released his FY 2015 budget, laying out his priorities and proposals for the coming years. The budget would reform the nation's immigration system, repeal a portion of future sequester cuts, reform the corporate tax code, and make new investments while also reducing health care costs, identifying targeted spending cuts, and raising new tax revenue.

Our main findings from the budget are:

- Relative to the President's own baseline, the budget includes $2.15 trillion of deficit reduction. Relative to current law with continued reductions in war spending, the budget calls for about $730 billion of deficit reduction.
- Under the President's budget, debt would peak at 74.6 percent of GDP in 2015 and then fall continuously to 69 percent by 2024. In dollar terms, debt will rise from about $12.5 trillion today to almost $19 trillion by 2024.
- Adjusted for timing shifts, deficits will fall from 4.1 percent of GDP in 2013 to 2.2 by 2017, and will remain around 2 percent through 2024.
- Spending will average 21.4 percent of GDP over the decade and reach 21.7 percent by 2024 while revenue will average 19.2 percent and reach 19.9 percent by 2024. Historically, spending and revenue have averaged 20.4 and 17.4 percent of GDP, respectively.
- OMB's economic assumptions are more optimistic than CBO – they assume real GDP will be more than 2 percent higher in 2024 than CBO does. This difference could be the result of immigration reform, which CBO has estimated could raise GDP by over 3 percent.

Encouragingly, the President's budget holds to the important principle of pay-as-you-go budgeting by proposing specific offsets for all new initiatives. It also puts forward additional proposals to reduce deficits below current law levels. These include a number of important reforms to Medicare and the tax code. At the same time, debt levels under the President's budget remain too high, and could be far higher with more pessimistic economic or policy assumptions.

We are disappointed that the President's budget no longer calls for provisions the President previously supported, especially the adoption of the Chained CPI. Securing our entitlement programs will require more structural reforms that build on the President's prior proposals, not subtract from them.

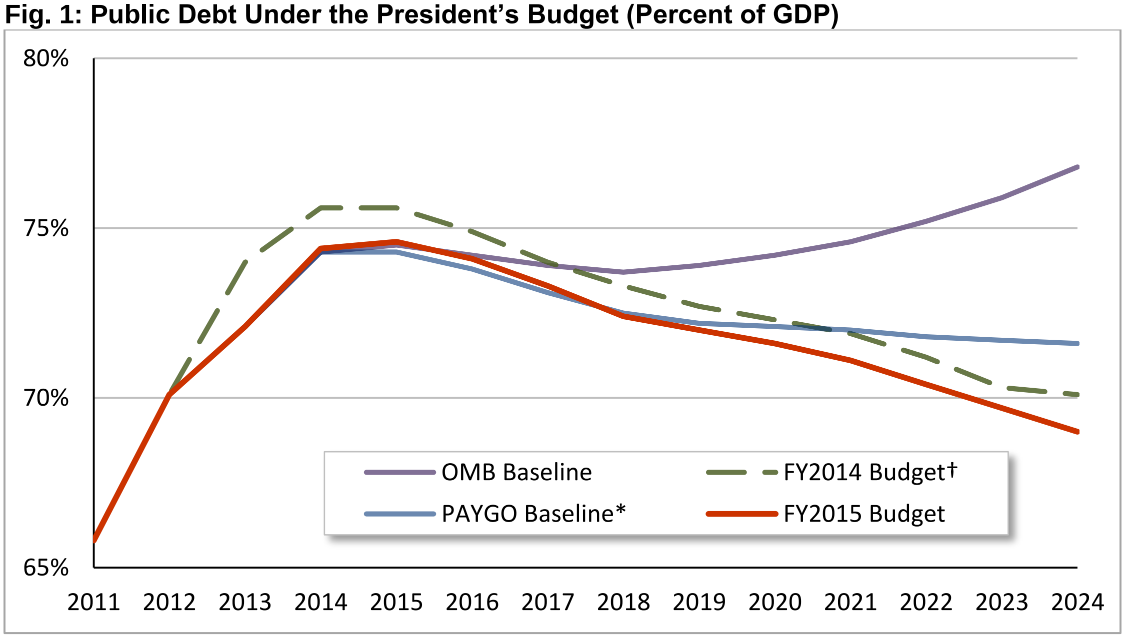
We hope the President will keep these policies on the table, and that his budget can serve as an opening for further discussions to improve the fiscal situation.

Spending, Revenue, Deficits, and Debt in the President's Budget

Although debt levels would continue to grow in nominal dollar terms in the President's budget – from about $12.5 trillion now to nearly $19 trillion by 2024 – this growth would be slower than the growth of the economy. As a result, according to estimates from the President's Office of Management & Budget (OMB), debt will decline as a share of the economy over the decade.

After peaking at a post-war record of 74.6 percent of GDP in 2015, OMB estimates the debt to GDP ratio would fall to 69 percent of GDP by 2024. By comparison, debt levels would be 76.8 percent of GDP in 2024 under the OMB baseline, 71.6 percent under current law with the President's war drawdown and economic assumptions, and 70.3 percent at the end of the decade in the President's FY2014 budget.†

Fig. 1: Public Debt Under the President's Budget (Percent of GDP)



* PAYGO baseline assumes continuation of current law, including inflation adjustments of the 2021 post-sequester discretionary levels, along with a drawdown in war spending as in the President's budget.
† Adjusted by CRFB to account for new BEA method for measuring GDP.

Declining debt levels largely stem from a combination of the economic recovery, forecasts for improved economic growth, the continued implementation of deficit reduction measures enacted over the past few years, a continuation in the recent health care slowdown, and the assumption that war spending will decline substantially in the next couple of years and end after 2021. In addition, the President's budget proposes offsets to new spending increases and additional reforms to reduce deficits below current law levels.

As a result of these and other factors, the President's budget (after timing shifts) projects deficits to fall from 4.1 percent of GDP in 2013 and 3.7 percent in 2014 to 3.1 in 2015, 2.1 percent by 2018, and 1.8 percent in 2023 and 2024. In dollar terms, deficits will fall from $680 billion in 2013 to just below $500 billion in 2016 and will remain near that level over the course of the decade.

These deficits reflect a growth in both spending and revenue over the coming decade, with revenue growing more rapidly than spending. Specifically, OMB projects revenue to rise from 16.7 percent of GDP in 2013 and 17.3 percent in 2014 to 19 percent of GDP by 2018 and 19.9 percent by 2024. Meanwhile, spending will grow from 20.8 percent of GDP in 2013 to 21.7 percent of GDP by 2024.

At 19.9 and 21.7 percent of GDP in 2024, respectively, revenue and spending would both be well higher than the historical averages of 17.4 and 20.4 percent of GDP. They would also both be higher than if the administration's proposals were not enacted; under current law with the President's war drawdown, revenue and spending would be 19.0 and 21.5 percent of GDP, respectively. A portion of this difference – 0.2 to 0.3 percentage points – is due to the higher revenue and spending from demographic changes under immigration reform.

Fig. 2: Budget Projections (Percent of GDP)

Fiscal Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	Ten-Year*
REVENUES													
FY2015 Budget	16.7%	17.3%	18.3%	18.6%	18.9%	19.0%	19.0%	19.2%	19.4%	19.6%	19.8%	19.9%	19.2%
OMB Baseline	16.7%	17.3%	17.8%	18.0%	18.1%	18.2%	18.3%	18.4%	18.6%	18.7%	18.8%	19.0%	18.4%
PAYGO Baseline*	16.7%	17.3%	17.8%	18.0%	18.1%	18.2%	18.3%	18.4%	18.6%	18.7%	18.8%	19.0%	18.4%
CBO Baseline	16.7%	17.5%	18.2%	18.2%	18.1%	18.0%	18.0%	18.0%	18.1%	18.1%	18.2%	18.4%	18.1%
FY2014 Budget†	16.1%	17.2%	18.0%	18.2%	18.2%	18.3%	18.5%	18.7%	18.9%	19.1%	19.3%	N/A	18.5%
OUTLAYS													
FY2015 Budget	20.8%	21.1%	21.4%	21.2%	21.1%	21.1%	21.3%	21.4%	21.5%	21.5%	21.6%	21.7%	21.4%
OMB Baseline	20.8%	21.0%	20.9%	20.8%	20.9%	21.0%	21.2%	21.5%	21.7%	22.0%	22.3%	22.6%	21.6%
PAYGO Baseline*	20.8%	20.9%	20.8%	20.5%	20.5%	20.6%	20.7%	20.9%	21.1%	21.2%	21.3%	21.5%	20.9%
CBO Baseline	20.8%	20.5%	20.9%	20.9%	21.0%	21.3%	21.4%	21.7%	21.9%	22.1%	22.3%	22.6%	21.7%
FY2014 Budget†	21.9%	21.4%	21.1%	20.7%	20.6%	20.7%	20.8%	20.9%	21.0%	21.0%	21.0%	21.1%	20.9%
DEFICITS													
FY2015 Budget	4.1%	3.7%	3.1%	2.6%	2.3%	2.1%	2.3%	2.2%	2.1%	1.9%	1.8%	1.8%	2.2%
OMB Baseline	4.1%	3.6%	3.1%	2.8%	2.8%	2.8%	3.0%	3.0%	3.1%	3.3%	3.4%	3.6%	3.1%
PAYGO Baseline*	4.1%	3.6%	2.9%	2.5%	2.4%	2.4%	2.4%	2.5%	2.5%	2.4%	2.4%	2.5%	2.5%
CBO Baseline	4.1%	3.0%	2.6%	2.6%	2.9%	3.3%	3.4%	3.7%	3.8%	4.0%	4.0%	4.2%	3.5%
FY2014 Budget†	5.8%	4.3%	3.1%	2.5%	2.3%	2.4%	2.2%	2.1%	2.0%	1.8%	1.6%	N/A	2.4%
DEBT													
FY2015 Budget	72.1%	74.4%	74.6%	74.1%	73.3%	72.4%	72.0%	71.6%	71.1%	70.4%	69.7%	69.0%	N/A
OMB Baseline	72.1%	74.3%	74.5%	74.2%	73.9%	73.7%	73.9%	74.2%	74.6%	75.2%	75.9%	76.8%	N/A
PAYGO Baseline*	72.1%	74.3%	74.3%	73.8%	73.1%	72.5%	72.2%	72.1%	72.0%	71.8%	71.7%	71.6%	N/A
CBO Baseline	72.1%	73.6%	73.2%	72.4%	72.2%	72.6%	73.3%	74.2%	75.3%	76.6%	77.8%	79.2%	N/A
FY2014 Budget†	74.0%	75.6%	75.6%	74.9%	74.0%	73.3%	72.7%	72.3%	71.9%	71.2%	70.3%	N/A	N/A

Note: All estimates adjusted for timing shifts.
* PAYGO baseline assumes continuation of current law, including inflation adjustments of the 2021 post-sequester discretionary levels, along with a drawdown in war spending as in the President's budget.
† Adjusted by CRFB to account for new BEA method for measuring GDP.

Proposals in the President's Budget

The President's budget includes a number of initiatives, which as a whole increase deficits in the near-term but reduce them over the medium- and long-term. The President's new spending and tax break proposals are matched with specific offsets along with further deficit reduction.

New Investments – The President's budget includes several major new initiatives. Specifically, it would establish universal pre-school, expand the EITC for workers without children, increase transportation spending, and fully fund the highway trust fund through at least 2018. Universal pre-school would be funded by nearly doubling and indexing the cigarette tax, the EITC expansion would be funded by closing various tax loopholes, and the transportation spending would be funded with temporary revenue gains generated from corporate tax reform.

Discretionary Spending/Sequestration – Under current law, discretionary spending caps for 2014 and 2015 are set by the Bipartisan Budget Act of 2013 and caps for 2016 through 2021 are set by the sequestration cuts in the Budget Control Act of 2011. The President's budget would restore non-defense discretionary spending to pre-sequester levels in FY2015, a $28 billion increase, and raise the defense caps by the same amount (about $17 billion below pre-sequester levels). The budget would offset these costs through a mix of new revenue from limiting the value of retirement accounts and spending cuts, largely from reductions in farm subsidies.

Beyond 2016, the President's budget would grow discretionary spending somewhat slower than inflation, continuing to spend more than under sequestration but by decreasing amounts over time. Through 2021, the budget would effectively reduce the non-defense discretionary sequester by about three-quarters and the defense sequester by about half. In 2021, the last year of the sequester, the cuts to these two areas would be reduced by two-fifths and one-quarter, respectively. The budget offsets these costs with the net savings from revenue and other mandatory changes throughout the budget.

The President would also fully repeal the sequester's cuts to mandatory spending, including the 2 percent reduction in Medicare payments to providers and insurers.

Health Savings – The budget includes about $400 billion in health savings, composed almost entirely of policies from previous budgets. Roughly $155 billon of savings come from reducing prescription drug payments, particularly by requiring rebates from drug companies for low-income beneficiaries in Medicare Part D. Another $110 billion of savings would come from reducing payments to post-acute care providers, and $55 billion from expanding income-related premiums in Medicare Part B and Part D. The budget's cost-sharing reforms are now slated to begin in 2018, one year later than in previous budgets, and would save about $15 billion.

The budget calls for replacing the Sustainable Growth Rate (SGR) formula with one that promotes new payment models and more efficient delivery of care – similar to the reforms recently agreed to by the Senate Finance, House Ways & Means, and House Energy & Commerce Committees. They estimate a cost of about $115 billion, the cost of a payment freeze.

Fig. 3: Fiscal Impact of Proposals in the President's FY2015 Budget (2014-2024)

	OMB Baseline	PAYGO Baseline^
Investments and Other Initiatives w/ Dedicated Offsets	**-$80 billion**	**-$80 billion**
*Fund and Increase Highway and Related Spending**	*$70 billion*	*$70 billion*
Raise Transition Revenue from Tax Reform	*-$150 billion*	*-$150 billion*
Fund Universal Pre-School and Related Spending	*$75 billion*	*$75 billion*
Increase and Index Cigarette Tax	*-$80 billion*	*-$80 billion*
Expand Earned Income Tax Credit	*$60 billion*	*$60 billion*
Conform SECA Taxes, Reduce Carried Interest Loophole, and Other Tax Changes	*-$60 billion*	*-$60 billion*
Sequester Relief w/ Dedicated Offsets	**$310 billion**	**$545 billion**
Increase FY2015 Discretionary Spending	*$55 billion*	*$55 billion*
Reduce Farm Subsidies, Limit Retirement Accounts, Etc	*-$55 billion*	*-$55 billion*
Reduce FY2016-FY2021 Sequestration Cuts	*$315 billion*	*$315 billion*
Modify FY2022-FY2024 Discretionary Spending Levels	*-$175 billion*	*$50 billion*
Repeal Mandatory Sequester Cuts	*$170 billion*	*$180 billion*
Health Care Reforms	**-$400 billion**	**-$285 billion**
Reform the Sustainable Growth Rate ("Doc Fixes")	*$0 billion*	*$115 billion*
Reduce Spending on Prescription Drugs	*-$155 billion*	*-$155 billion*
Reduce Spending on Post-Acute Care	*-$110 billion*	*-$110 billion*
Increase Means-testing of Medicare Premiums	*-$55 billion*	*-$55 billion*
Increase Cost Sharing in Medicare	*-$15 billion*	*-$15 billion*
Reduce Other Health Care Spending	*-$65 billion*	*-$65 billion*
Other Spending Changes	**$80 billion**	**$80 billion**
Increase Spending on Education and Infrastructure	*$50 billion*	*$50 billion*
Extend Unemployment Benefits and Promote Jobs	*$50 billion*	*$50 billion*
Increase Other Spending	*$55 billion*	*$55 billion*
Reduce Social Security Fraud	*-$30 billion*	*-$30 billion*
Increase PBGC Premiums	*-$20 billion*	*-$20 billion*
Other Spending Reductions and User Fees	*-$30 billion*	*-$30 billion*
Revenue Changes	**-$935 billion**	**-$780 billion**
Extend Expiring Refundable Tax Credits	*$0 billion*	*$155 billion*
Enact Tax Breaks for Families, Jobs, and Infrastructure	*$85 billion*	*$85 billion*
Limit Value of Tax Preferences to 28%	*-$600 billion*	*-$600 billion*
Enact "Buffett Rule" to Set Minimum Tax	*-$55 billion*	*-$55 billion*
Reform and Increase Estate Tax	*-$130 billion*	*-$130 billion*
Reduce the Tax Gap	*-$70 billion*	*-$70 billion*
Impose Financial Responsibility Tax	*-$55 billion*	*-$55 billion*
Reform Unemployment Insurance Financing	*-$60 billion*	*-$60 billion*
Enact Other Revenue Raisers	*-$55 billion*	*-$55 billion*
Additional Cuts and Reforms	**-$885 billion**	**-$160 billion**
Enact Immigration Reform	-$160 billion	-$160 billion
Reduce Overseas Contingency Spending from Baseline	-$695 billion	$0 billion
Other Adjustments	-$35 billion	-$5 billion
Net Interest	**-$240 billion**	**-$40 billion**
Total Change in Deficit	**-$2,150 billion**	**-$730 billion**

Note: Numbers rounded to the nearest $5 billion and may not add due to rounding. Negative numbers reduce the deficit. Estimates by CRFB staff.

^ PAYGO baseline assumes continuation of current law, including inflation adjustments of the 2021 post-sequester discretionary levels, along with a drawdown in war spending as in the President's budget.

* The budget also dedicates nearly $80 billion toward funding current transportation spending.

Other Mandatory Spending Changes – The budget proposes a number of new spending initiatives as well as several money-saving reforms. New spending includes a one-year extension of expired unemployment benefits, funding of new training and assistance programs for the unemployed, increases in spending on higher education, and additional infrastructure spending. On the savings side the budget would increase PBGC premiums, crack down on fraud and abuse in Social Security, and establish or increase a number of user fees. The budget includes revenue from reforming unemployment financing and reducing the tax gap as mandatory savings. Notably absent from the budget is a long-standing proposal from the President to increase pension contributions for current federal employees.

Revenue Changes – The President's budget proposes a number of new tax breaks as well as new revenue. In addition to extending the refundable child, education, and earned income credits which end in 2017, the budget proposes modest jobs and infrastructure incentives along with tax breaks for retirement savings, child care, housing, and higher education.

To increase revenue, the President's budget would limit the value of many itemized deductions and exclusions to the 28 percent tax bracket and impose a "Buffett Rule" to ensure very high earners pay at least a 30 percent tax rate. The budget would also impose a tax on large financial institutions, restore the estate tax to its 2009 parameters starting in 2019, reinstate certain expiring taxes, and reduce the tax gap, among other changes.

Finally, the budget calls for corporate tax reform to reduce rates by broadening the tax base. The budget identifies about $250 billion of net corporate revenue to contribute to this endeavor. However, reducing the corporate rate to 28 percent and setting funds aside for transportation infrastructure as the President has proposed could cost four times that.

Immigration Reform – The President's budget calls for comprehensive immigration reform**.** Specifically, it endorses the Senate-passed immigration bill, which would reduce deficits by $160 billion over ten years. The Senate bill would increase spending by about $300 billion and revenue by roughly $455 billion, largely by increasing the size of the labor force. The net deficit reduction is a combination of nearly $210 billion in improvements to Social Security and $50 billion larger deficits in the rest of the budget.

War Spending – The President's budget requests $85 billion for overseas contingency operations for FY2015, a slight reduction from the $92 billion appropriated this year. Beyond 2015, the budget assumes $30 billion of war spending a year through 2021 and $0 of spending beyond that, reflecting the continued withdrawing of troops from abroad. Because baseline conventions assume spending will grow with inflation, the budget counts spending below the baseline as deficit reduction. However, these savings should be treated with skepticism for two reasons. First, a large portion of these savings reflect a war drawdown already in place rather than new additional spending cuts. And secondly, the spending levels may be unrealistically low and not reflective of a policy that this president nor his successor is able to abide by. We will address these issues further in future analysis.

Economic Assumptions

Economic projections and assumptions are an important determinant of the country's fiscal health. Whereas recent CBO projections showed a deteriorating fiscal picture in part due to assumptions of continued weakness in the labor markets, OMB does not project a similar weakness. Unlike CBO, OMB projects the economy will return to potential later in the decade.

Over the next decade, OMB projects average real growth of 2.7 percent per year, compared to CBO's estimate of 2.5. OMB projects real GDP growth of 3.1 percent in 2014 and 3.4 percent in 2015, compared to 2.7 and 3.3 percent, in CBO's projections, 2.8 and 3.0 percent in the Blue Chip estimates, and 3.0 and 3.2 in Federal Reserve projections. By the end of the budget window, OMB projects annual growth of 2.3 percent, whereas CBO projects growth closer to 2 percent. In total, OMB assumes the economy will be more than 2 percent larger in 2024 than does CBO – though it is possible that this is driven at least in part by the immigration reform in the budget, which CBO has estimated could raise GDP by over 3 percent.

Meanwhile, OMB projects the unemployment rate will fall to 5.4 percent by 2018 and remain there, while CBO projects it will still be at 5.8 percent in 2018 and reach 5.5 percent by 2023.

Fig. 4: Economic Projections (Calendar Year)

Calendar Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	Ten – Year^
Real GDP Growth													
FY2015 Budget	1.7%	3.1%	3.4%	3.3%	3.2%	2.8%	2.5%	2.4%	2.3%	2.3%	2.3%	2.3%	2.7%
CBO (February)	1.7%	2.7%	3.3%	3.4%	3.0%	2.4%	2.3%	2.2%	2.2%	2.1%	2.1%	2.0%	2.5%
Blue Chip	1.9%	2.9%	3.0%	2.9%	2.7%	2.6%	2.5%	2.4%	2.4%	2.4%	2.4%	2.4%	2.6%
Federal Reserve†	2.3%	3.0%	3.2%	2.9%	2.4-2.7%								N/A
FY2014 OMB MSR	2.0%	3.1%	3.5%	3.5%	3.5%	2.9%	2.5%	2.4%	2.4%	2.3%	2.3%	N/A	2.8%
Inflation (CPI)													
FY2015 Budget	1.4%	1.6%	2.0%	2.1%	2.2%	2.3%	2.3%	2.3%	2.3%	2.3%	2.3%	2.3%	2.2%
CBO (February)	1.5%	1.7%	2.0%	2.1%	2.2%	2.4%	2.4%	2.4%	2.4%	2.4%	2.4%	2.4%	2.3%
Blue Chip	1.5%	1.6%	2.0%	2.2%	2.4%	2.4%	2.4%	2.3%	2.3%	2.3%	2.3%	2.3%	2.3%
Federal Reserve*	1.0%	1.5%	1.8%	1.9%	N/A								
FY2014 OMB MSR	1.4%	1.9%	2.2%	2.2%	2.2%	2.2%	2.2%	2.2%	2.2%	2.2%	2.2%	N/A	2.2%
Unemployment Rate													
FY2015 Budget	7.5%	6.9%	6.4%	6.0%	5.6%	5.4%	5.4%	5.4%	5.4%	5.4%	5.4%	5.4%	5.6%
CBO (February)	7.4%	6.8%	6.5%	6.1%	5.9%	5.8%	5.7%	5.7%	5.6%	5.6%	5.5%	5.5%	5.8%
Blue Chip	7.4%	6.6%	6.1%	6.1%	5.8%	5.6%	5.6%	5.6%	5.6%	5.6%	5.6%	5.6%	5.7%
Federal Reserve†	7.0%	6.5%	5.9%	5.6%	5.2-6.0%								N/A
FY2014 OMB MSR	7.5%	7.0%	6.5%	6.0%	5.6%	5.4%	5.4%	5.4%	5.4%	5.4%	5.4%	N/A	5.8%
Gross Domestic Product (Fiscal Year, Trillions)													
FY2015 Budget	$16.6	$17.3	$18.2	$19.2	$20.2	$21.2	$22.2	$23.2	$24.2	$25.3	$26.4	$27.5	N/A
CBO (February)	$16.6	$17.3	$18.1	$19.1	$20.1	$21.0	$21.9	$22.8	$23.8	$24.7	$25.8	$26.8	N/A

^ Ten-year figures refer to 2015-2024 for CBO, FY2015 budget, and Blue Chip data and 2014-2023 for the MSR.
* Numbers reflect PCR index, which is on average 0.2 to 0.3 percentage points lower than the CPI.
† Figures for the Federal Reserve's growth and unemployment projections for 2014-2016 reflect average of the central tendency."

The relatively optimistic assumptions in the President's budget may be partially responsible for the promising debt projections, though further analysis is needed to know for sure.

Conclusion

The President's budget reflects the priorities of this administration, and responsibly identifies offsetting revenue increases and spending reductions to pay for new initiatives. Encouragingly, the President's budget also goes beyond these offsets by proposing health, tax, and immigration reforms that would reduce deficits further.

As a result of the President's policy proposals, projections of improved economic growth, a rapid drawdown in war spending, and other factors, the President's budget would put debt on a downward path as a share of GDP. The debt to GDP ratio would fall from a record high of nearly 75 percent in 2015 to 69 percent by 2024. If these projections materialized, it would be a very positive step.

At the same time, we are worried that debt might not shrink as projected if OMB's economic assumptions do not materialize, or if war spending is unable to be drawn down as quickly as the budget suggests. We are also concerned that the President's budget takes a step backwards by excluding the President's previous proposal to adopt the chained CPI as part of a bipartisan deficit reduction package. Given the looming insolvency of the Social Security system and growing long-term debt levels, we wish the President had instead proposed *additional* reforms to secure the country's entitlement programs, rather than fewer.

We hope that Congress and the President will work together to enact the best parts of this budget and agree to a long-term plan to put the economy and debt on a more sustainable path. Any serious effort will require presidential leadership on this issue.