

*The President's Fiscal Year 2006 Budget:**As significant for what it omits as for what it includes***I. Overview**

The federal budget is headed for increasingly difficult waters but President Bush's proposals for fiscal year 2006 focus on reorganizing the deck chairs. The President's budget would reduce spending by \$77 billion relative to the baseline over the 2006 to 2010 period, but it would cut taxes by even more—\$106 billion.¹ As a result, deficits under the President's policies would total \$1,393 billion over the five-year period—\$29 billion *more* than the baseline projection of \$1,364 billion.

Impact of Policy Changes Proposed in the President's Budget for FY 2006

In billions of dollars

	2005	2006	2007	2008	2009	2010	Total: 2006-2010
Baseline Deficits	-391	-369	-315	-256	-213	-211	-1,364
Proposed Changes:							
Tax Cuts	0	0	-4	-21	-50	-32	-106
Defense increases	-35	-32	-28	-19	-28	-30	-137
Outlay effects of tax proposals	-0	-0	-4	-6	-7	-7	-23
Non-defense discretionary cuts	0	8	27	40	52	61	188
Medicaid cuts	0	-1	2	4	4	5	13
Other mandatory cuts	0	6	11	9	12	11	49
Debt service impact	<u>-1</u>	<u>-2</u>	<u>-2</u>	<u>-2</u>	<u>-3</u>	<u>-4</u>	<u>-12</u>
Net Changes	-36	-21	2	5	-20	4	-29
President's Budget Deficits	-427	-389	-312	-251	-233	-207	-1,393

Note: Changes shown as negative amounts would increase deficits. Changes shown as positive amounts reduce deficits.

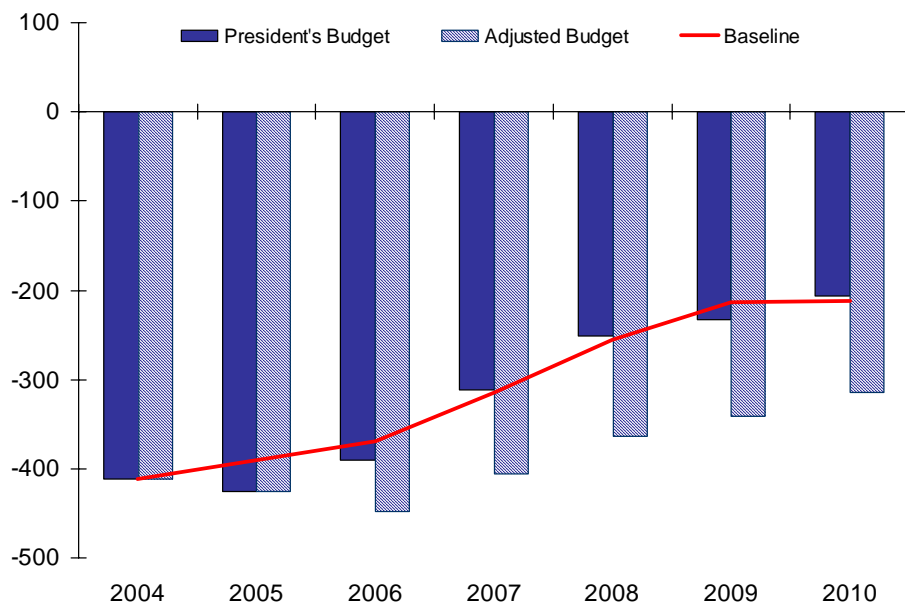
¹ This brief uses the baseline constructed by the Office of Management and Budget (OMB) that follows the same rules as the Congressional Budget Office (CBO) uses for its projections. Under that baseline, which OMB calls the "BEA baseline" (after the Budget Enforcement Act of 1997), 2006 to 2010 deficits projections are \$13 billion higher than the Administration's preferred "current services" baseline. The BEA baseline assumes that tax cuts expire as scheduled and extends the hurricane supplemental enacted in 2005 and other small adjustments.

The Administration has defined spending, not deficits, as the primary problem. Nevertheless, the President has promised to cut the deficit in half by 2009. That is not an especially high bar since baseline projections show that it could almost be achieved by leaving baseline policies alone. But the Administration has some policy priorities — particularly making the 2001 and 2003 tax cuts permanent and adding funds for national security — and these priorities add to the baseline deficits. To pay for them, the budget would: cut non-defense discretionary programs; reduce spending for entitlement programs including Medicaid, agricultural assistance, food stamps, student loans, unemployment assistance and the Pension Benefit Guaranty Corporation; and increase user fees. However, even with these trade-offs the overall impact of the President’s proposed policies is a slight increase in projected deficits.

II. Worse than Meets the Eye

While the President’s budget does not appear to add significantly to the budget’s woes, it leaves out major costs that are likely to require accommodation. Deficit projections are much deeper if the budget is adjusted to include additional funding in 2006 and beyond for activities related to Iraq, Afghanistan and the global war on terror; and to extend relief beyond December 2005 for middle class taxpayers from the effects of the alternative minimum tax (see figure 1).

Figure 1. Deficit Projections under the Baseline, the President’s Budget and the Adjusted Budget



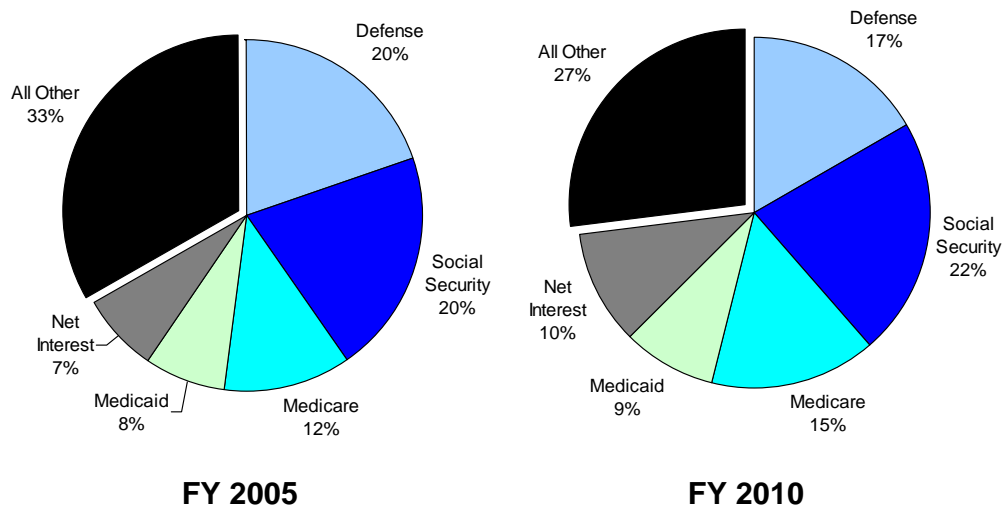
SOURCE: Concord Coalition, based upon *The FY 2006 Budget*, February 2005.

The budget also excludes the effects of a major presidential initiative—the creation of individual retirement accounts that would divert Social Security payroll tax revenues away from the Treasury. According to Administration estimates, that would increase deficits by \$754 billion over the next 10 years alone. And by limiting its projections to five years (through 2010), the budget only has to acknowledge \$53 billion (5 percent) of the \$1.1 trillion cost of extending the 2001 and 2003 tax cuts over the 2006 to 2015 period. Also undisclosed is the explosive growth in Medicare that will cause that program to increase by almost a full percentage point of GDP (from 2.4 to 3.3 percent) over the next 10 years, even when the baby boomer beneficiaries are relatively young and healthy.

III. Guns and Geritol

The FY 2006 budget provides a vision of the federal government’s future under the President’s policies. Increasingly, the budget will support defense needs and older people while all other areas shrink (see figure 2). Social Security, Medicare, and Medicaid (notwithstanding the proposed cuts) will continue to grow, rising from \$1 trillion in 2005 to \$1.4 trillion in 2010. Defense is projected increase only modestly from \$463 billion to \$502 billion, but that assumes no new funding for Iraq, Afghanistan, and the war on terror after 2005. Interest costs will also rise as the public debt grows from \$4.7 trillion in 2005 to \$6.2 trillion in 2010. In fact, over the next 5 years interest costs are the fastest growing spending category in the budget, rising by 76 percent and exceeding even the pace of Medicare growth (58 percent).

Figure 2. Composition of the President’s Budget Outlays in 2005 and 2010

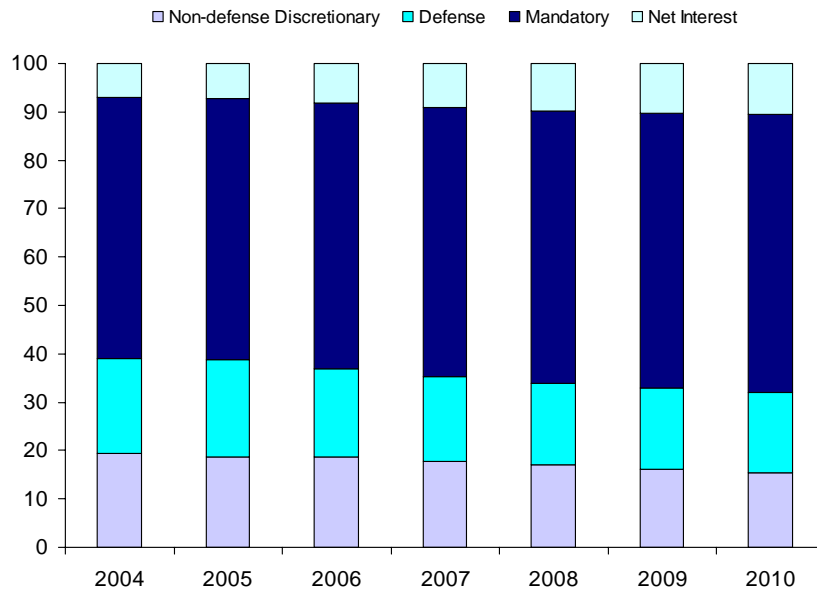


IV. Automatic Pilot Taking Over

Under the budget, overall discretionary spending would drop from 7.9 to 6.1 percent of GDP. Non-defense discretionary programs would really feel the squeeze. They would contribute 75 percent of the proposed offsets for tax cuts and higher defense spending. By 2010, spending for those programs would fall to 3 percent of gross domestic product (GDP) compared to 3.8 percent in 2005. Achieving these savings on paper is easier to accomplish than it will be in practice. By OMB's count, 60 percent of the 99 programs that have been targeted for elimination have survived similar efforts in the past. The same is true for roughly half of the "major program reductions" proposed in the budget.

The President's budget projects that total spending will be nearly \$550 billion higher in 2010 than it will be this year. All but \$6 billion of that growth will be on the mandatory side of the budget. Medicare spending will be \$170 billion higher in 2010 than in 2005, Social Security spending will increase \$150 billion, and net interest costs will grow by \$136 billion. As a result of the President's proposals, in 2010 only 32 percent of the budget will be determined by annual appropriations. The remaining 68 percent will consist of entitlements and other mandatory spending and net interest (see figure 3).

Figure 3. Federal Spending by Budget Category under the President's FY 2006 Budget



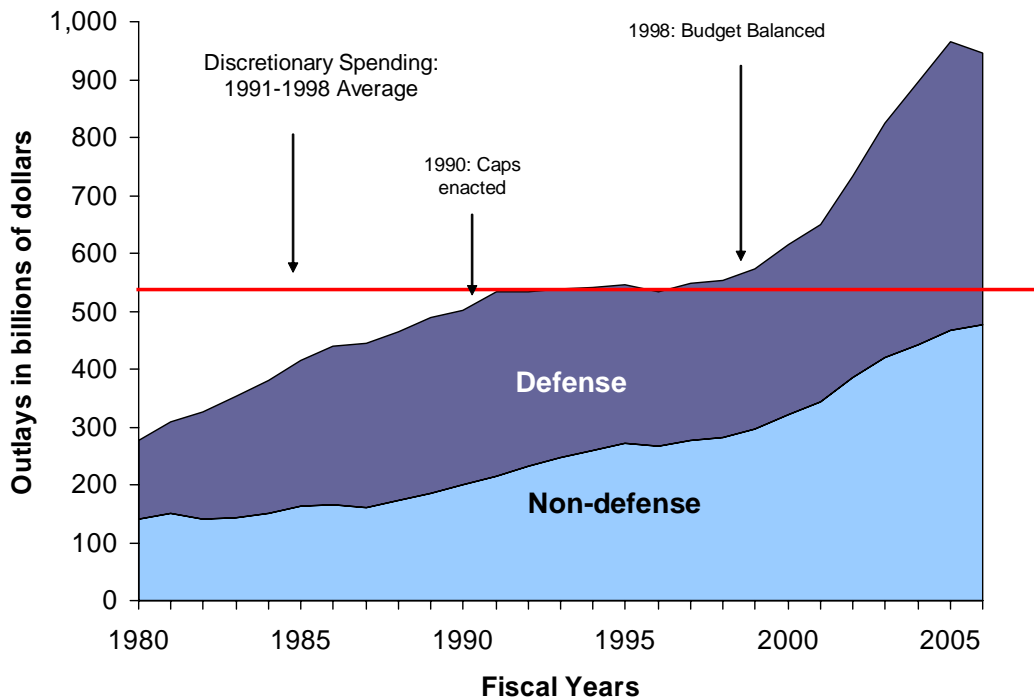
Source: OMB, *Historical Tables, FY 2006 Budget*, February 2005.

V. On a More Positive Note . . .

By acknowledging that some restraint is required, the President's budget does take a tentative, first step towards addressing the budget's distress. Resolving short- and long-term fiscal imbalance will not be easy, but controlling spending is obviously necessary. Where the budget falls short, however, is focusing only on spending. If policy makers fail in their efforts to limit spending, then they must be willing to consider increasing resources available to pay for their policies. In the President's budget, spending remains at or above 19 percent of GDP—even with all of the proposed restraint and cuts. Revenues, on the other hand, never get above 17.7 percent of GDP—even assuming a growing windfall from the alternative minimum tax. This implies a structural mismatch that only threatens to grow wider beyond the next 5 years as the spending pressures of the boomers' retirement years coincides with a revenue stream that has been diminished to a consistent level not seen since the 1950s.

The good news is that strong budget enforcement measures can help. Caps on discretionary spending worked during the 1990s until budget surpluses made them seem unnecessary (see figure 4). Pay-as-you-go requirements—applied to revenues as well as entitlement spending—kept short-term problems from getting worse. Those measures should be reinstated. They are proven tools that will help lawmakers rein in deficits.

Figure 4. Discretionary Spending Before, During, and After the Caps



Source: OMB *Historical Tables*, February 2005.

VI. A Simple Test: Will Future Generations Be Made Better or Worse Off?

The budget faces a very steep uphill battle. Across the country and within the Congress analysts and advocates are identifying lost federal funds. The proposed cuts to programs are very real to those who currently benefit. What is harder to calculate are the benefits of a disciplined fiscal policy. As the political process sorts out the individual winners and losers in the coming months, lawmakers should not lose sight of the gains or losses that will accrue to future generations.

The President's budget already shows the extent to which current policy makers' hands are tied by the decisions taken years ago. It is up to this generation of decision makers to decide if they will make future fiscal problems better or worse. They can put Congresses to come in increasingly tighter boxes, or they can make it easier for future lawmakers to address new needs and new priorities.