ANALYTICAL PERSPECTIVES

BUDGET OF THE UNITED STATES GOVERNMENT

Fiscal Year 2005

THE BUDGET DOCUMENTS

Budget of the United States Government, Fiscal Year 2005 contains the Budget Message of the President, information on the President's budget and management priorities, and budget overviews organized by agency, including assessments of their performance.

Analytical Perspectives, Budget of the United States Government, Fiscal Year 2005 contains analyses that are designed to highlight specified subject areas or provide other significant presentations of budget data that place the budget in perspective. This volume includes economic and accounting analyses; information on Federal receipts and collections; analyses of Federal spending; detailed information on Federal borrowing and debt; baseline or current services estimates; and other technical presentations.

This year, the *Analytical Perspectives* volume contains a CD–ROM with certain information that was previously published in the budget documents, such as evaluations and analyses of programs and management at Federal departments and agencies, as well as lists of Federal programs by agency and account and by budget function.

Historical Tables, Budget of the United States Government, Fiscal Year 2005 provides data on budget receipts, outlays, surpluses or deficits, Federal debt, and Federal employment over an extended time period, generally from 1940 or earlier to 2009. To the extent feasible, the data have been adjusted to provide consistency with the 2005 Budget and to provide comparability over time.

Budget of the United States Government, Fiscal Year 2005—Appendix contains detailed information on the various appropriations and funds that constitute the budget and is designed primarily for the use of the Appropriations Committee. The *Appendix* contains more detailed financial information on individual programs and appropriation accounts than any of the other budget documents. It includes for each agency: the proposed text of appropriations language, budget schedules for each account, new legislative proposals, explanations of the work to be performed and the funds needed, and proposed general provisions applicable to the appropriations of entire agencies or group of agencies. Information is also provided on certain activities whose outlays are not part of the budget totals.

AUTOMATED SOURCES OF BUDGET INFORMATION

The information contained in these documents is available in electronic format from the following sources:

Budget CD-ROM. The CD-ROM contains all of the budget documents and software to support reading, printing, and searching the documents. The CD-ROM also has many of the tables in the budget in spreadsheet format. The budget CD–ROM also contains the material on the *Analytical Perspectives* CD–ROM.

Internet. All budget documents, including documents that are released at a future date, will be available for downloading in several formats from the Internet. To access documents through the *World Wide Web,* use the following address:

http://www.whitehouse.gov/omb/budget

For more information on access to electronic versions of the budget documents (except CD–ROMs), call (202) 512–1530 in the D.C. area or toll-free (888) 293–6498. To purchase the budget CD–ROM or printed documents call (202) 512-1800.

GENERAL NOTES

1. All years referred to are fiscal years, unless otherwise noted.
2. Detail in this document may not add to the totals due to rounding.
3. At the time of this writing, 7 of the 13 appropriations bills for 2004 were not enacted, and the programs covered by them were operating under a continuing resolution. For these programs, references to 2004 spending, including current services or baseline estimates, in the text and tables reflect the conference report on H.R. 2673, the Consolidated Appropriations Bill, 2004.

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INTRODUCTION

1. INTRODUCTION

Purpose of This Volume

The *Analytical Perspectives* volume presents analyses that highlight specific subject areas or provide other significant budget data that place the budget in context. The volume presents crosscutting analyses of Government programs and activities from various perspectives.

Presidential budgets have included separate analytical presentations of this kind for many years. The *1947 Budget* and subsequent budgets included a separate section entitled "Special Analyses and Tables" that covered four or more topics. For the *1952 Budget,* this section was expanded to have ten analyses, including many subjects that are still covered today, such as receipts, investment, credit programs, and aid to State and local governments. With the *1967 Budget* this material became a separate volume entitled "Special Analyses," and included 13 chapters. The material has generally remained a separate volume since then, with the exception of the budgets for 1991–1994, when the material was included in one large volume with other budget material. Beginning with the *1995 Budget*, the volume has been named *Analytical Perspectives*.

Changes from the *2004 Analytical Perspectives* Volume

The volume this year reflects an interest in publishing more information on program performance, so that Executive agencies, the Congress, and the public will become increasingly informed about how well programs are performing. Better performance information can help managers improve program effectiveness, and can help Executive and Congressional policymakers improve the allocation of public resources. The performance assessment information is summarized in Chapter 2, "Performance and Management Assessments," and discussed in many other chapters, especially those in the section, "Crosscutting Programs."

In order to present a smaller document, this year many tables that have been included in prior years are no longer printed in this volume but are included as part of the budget on the enclosed *Analytical Perspectives* CD ROM. A list of the items on the CD ROM is in the Table of Contents of this volume.

The next section discusses briefly the material covered in each chapter, and technical changes in the chapter from last year's volume.

Summary of the Chapters in This Volume

Introduction

1. Introduction. This chapter highlights the changes in this volume compared to last year, particularly the new emphasis on performance in a crosscutting context.

Performance and Management Assessments

2. Budget and Performance Integration and the Program Assessment Rating Tool. This chapter summarizes this year's performance and management assessments, based primarily on the Program Assessment Rating Tool (PART). The enclosed *Analytical Perspectives* CD ROM includes one-page summaries of the program evaluations. This material is similar to the separate volume published last year, *FY 2004 Performance and Management Assessments*. Details of each of the assessments can be found on the OMB web page under "Budget Documents" at *http://www.whitehouse.gov/omb/* .

Crosscutting Programs

3. Homeland Security Funding Analysis. This chapter discusses homeland security funding and provides information on homeland security program requirements, performance, and priorities. Additional detailed information is available on the enclosed *Analytical Perspectives* CD ROM.

4. Strengthening Federal Statistics. This chapter discusses the development of standards that principal statistical programs can use to assess their performance and presents highlights of their *2005 Budget* proposals.

5. Research and Development. This chapter presents a crosscutting review of research and development funding in the budget, including discussions about priorities, performance, and coordination across agencies.

6. Federal Investment. This chapter discusses spending across Federal agencies that yields long-term benefits, and presents information on physical capital, research and development, and education and training. For the first time the chapter includes material on the PART assessments related to direct Federal investment spending. There is also a section on capital stocks. The sections from last year on capital budgeting and supplemental capital spending are not included this year because they vary little from year to year, and the reader may refer to last year's chapter for this material.

7. Credit and Insurance. This chapter provides crosscutting analyses of the roles and risks of Federal credit and insurance programs and government sponsored enterprises (GSEs), as well as criteria for evaluation. It covers the categories of Federal credit (housing, education, business including farm operations, and international) and insurance programs (deposit insurance, pension guarantees, disaster insurance, and insurance against security-related risks). Two detailed tables that were part of this chapter last year, "Table 9–9. Direct Loan Transactions of the Federal Government" and "Table 9–10. Guaranteed Loan Transactions of the Federal Government" appear this year on the enclosed *Analytical Perspectives* CD ROM as Tables 7–10 and 7–11.

8. Aid to State and Local Governments. This discussion presents crosscutting information on Federal grants to State and local governments, including Administration proposals. For the first time the chapter includes material on the PART assessments related to grants. An Appendix to this chapter includes State-by-State spending estimates of major grant programs.

9. Integrating Services with Information Technology. This chapter presents a crosscutting look at investments in information technology (IT). The chapter describes various aspects of the Administration's information technology agenda, with special emphasis on the performance, efficiency, and effectiveness of the Government's IT investments. Two detailed tables that were part of this chapter last year, "Table 22–1. Effectiveness of Agency's IT Management and E-Gov Processes" and Table 22–2, which reported on the status of E-Gov initiatives, appear this year on the enclosed *Analytical Perspectives* CD ROM as Table 9–1, "Effectiveness of Agency's IT Management & E-Gov Processes" and Table 9–2, "Status of Presidential E-Government Initiatives."

10. Federal Drug Control Funding. This section presents estimated drug control funding for Federal departments and agencies.

Economic Assumptions and Analyses

11. Economic Assumptions. This discussion reviews recent economic developments; presents the Administration's assessment of the economic outlook, including the expected effects of macroeconomic policies; and compares the economic assumptions on which the budget is based with the assumptions for last year's budget and those of other forecasters.

12. Stewardship. This chapter assesses the Government's financial condition in an integrated framework that includes Federal assets and liabilities; 75-year projections of the Federal budget under alternative discretionary spending, health cost, productivity, and demographic assumptions; actuarial estimates for the shortfalls in Social Security and Medicare; a national balance sheet that shows the Federal contribution to national wealth; and a table of economic and social indicators. Together these elements serve similar analytical functions to a business's accounting statements.

13. National Income and Product Accounts. This chapter discusses how Federal receipts and outlays fit into the framework of the National Income and Product Accounts (NIPAs) prepared by the Department of Commerce. The NIPAs measures are the basis for reporting Federal transactions in the gross domestic product (GDP) and for analyzing the effect of the budget on aggregate economic activity.

Budget Reform Proposals

14. Budget Reform Proposals. This chapter is a brief description of the Administration's budget reform agenda for addressing the need for responsible budgeting and other reforms.

Federal Borrowing and Debt

15. Federal Borrowing and Debt. This chapter analyzes Federal borrowing and debt and explains the budget estimates. It includes sections on special topics such as the trends in debt, agency debt, investment by Government accounts, and the debt limit.

Federal Receipts and Collections

16. Federal Receipts. This discussion presents information on receipts estimates, enacted tax legislation, and the receipts proposals in the budget.

17. User Charges and Other Collections. This chapter presents information on receipts from regulatory fees and on collections from market-oriented activities, such as the sale of stamps by the Postal Service, which are recorded as offsets to outlays rather than as Federal receipts.

18. Tax Expenditures. This discussion describes and estimates tax expenditures, which are defined as revenue losses from special exemptions, credits, or other preferences in the tax code. This section is prepared by the Department of the Treasury.

Dimensions of the Budget

19. Comparison of Actual to Estimated Totals. This chapter compares the actual receipts, outlays, and deficit for 2003 with the estimates for that year published two years ago in the *2003 Budget.* It also includes a historical comparison of the differences between receipts, outlays, and the deficit as originally proposed with final outcomes.

20. Outlays to the Public, Net and Gross. This section provides information on outlays net and gross of offsetting collections. Offsetting collections that are netted against outlays result primarily from the Government's business-like activities, such as the sale of stamps by the Postal Service.

21. Trust Funds and Federal Funds. This chapter provides summary information on Federal funds and trust funds, which comprise the entire budget. For trust funds the information includes income, outgo, and balances. Two detailed tables that were part of this chapter last year, "Table 16–4. Income, Outgo, and Balances of Major Trust Funds" and "Table 16–5. Income, Outgo, and Balances of Selected Federal Funds" appear this year on the enclosed *Analytical Perspectives* CD ROM as Tables 21–4 and 21–5.

22. Off-Budget Federal Entities and Non-Budgetary Activities. This chapter provides summary information on the off-budget Federal entities (Social Security and Postal Service) and non-budgetary activities (such as cash flows for credit programs, deposit funds, and regulation).

23. Federal Employment and Compensation. This chapter provides summary data on the level and recent trends in civilian and military employment, and personnel compensation and benefits.

Current Services Estimates

24. Current Services Estimates. This chapter presents estimates, based on rules contained in the Budget Enforcement Act, of what receipts, outlays, and the deficit would be if no changes were made to laws already enacted. It discusses the conceptual framework for these estimates and provides an alternative formulation of a baseline, which is used in the main budget document. Two detailed tables that appeared in this chapter last year, "Table 15–11. Current Services Budget Authority by Function, Category, and Program" and "Table 15–12. Current Services Outlays by Function, Category, and Program" appear this year on the enclosed *Analytical Perspectives* CD ROM as Tables 24–12 and 24–13.

Budget System and Concepts and Glossary

25. The Budget System and Concepts. This is a basic reference to the budget process, concepts, laws, and terminology. The chapter includes information on the relationship of budget authority to outlays, which was formerly a separate chapter in this volume.

Other

The following tables appeared as separate sections last year in this volume and appear this year on the enclosed *Analytical Perspectives* CD ROM:

- **Detailed Functional Tables.** Two detailed tables, which last year appear as, "Table 25–1. Budget Authority by Function, Category, and Program" and "Table 25–2. Outlays by Function, Category, and Program", this year are combined on the enclosed *Analytical Perspectives* CD ROM as Table 26–1.

- **Federal Programs by Agency and Account.** This detailed table "Federal Programs by Agency and Account," appears this year on the enclosed *Analytical Perspectives* CD ROM as Table 27–1.

PERFORMANCE AND MANAGEMENT ASSESSMENTS

2. BUDGET AND PERFORMANCE INTEGRATION AND THE PROGRAM ASSESSMENT RATING TOOL

The President's Management Agenda (PMA) is helping the Federal Government become results-oriented. In addition to making it more efficient—reducing waste, fraud, and abuse—it is leading managers to ask whether programs are working as intended and if not, what can be done to achieve greater results.

Government programs, however worthy their goals, should demonstrate they are actually effective at solving problems. That is why it is so important that we consistently ask, for instance, whether the Generation IV Nuclear Energy Systems Initiative at the Department of Energy is meeting its goals toward creating a next-generation nuclear energy system, or whether the National Institutes of Health's HIV/AIDS Research program is on track to developing an HIV/AIDS vaccine by 2010. If we are not meeting our goals, then we should do something differently to address the shortfall. If we are not measuring our performance at all, that is a bigger problem.

The Program Assessment Rating Tool (PART) is designed to help assess the management and performance of individual programs. The PART helps evaluate a program's purpose, design, planning, management, results, and accountability to determine its overall effectiveness. Recommendations are then made to improve program management and performance.

The Administration has assessed approximately 400 programs representing approximately 40 percent of the Federal Budget; 234 programs were assessed last year and another 173 programs were assessed this year.[1] In three more years, the Administration plans to have assessed the performance and management of roughly 100 percent of the Federal Budget.

With the help of the PART, we know much more about the performance of 40 percent of the budget than we did before. This year, there is a reduction in the percentage of programs that cannot demonstrate results and there was a modest increase in the programs rated "Effective." Other results:

- About 40 percent of programs were rated either "Effective" or "Moderately Effective"; a quarter of programs rated just "Adequate" or "Ineffective"; and about 40 percent of programs were unable to demonstrate results.
- The PARTed programs for which we have current budget information show: almost $713 billion spent effectively or moderately effectively; almost $162 billion spent just adequately or ineffectively; and almost $209 billion spent on programs for which we cannot demonstrate results.

The goal of the Budget and Performance Integration Initiative (part of the President's Management Agenda) is to have the Congress and the Executive Branch routinely consider performance information, among other factors, when making management and funding decisions. This will enable the Government to better describe to taxpayers what they are getting for their money. The evolution and institutionalization of the PART goes a long way towards achieving this goal.

There are a number of programs that have substantially improved their management practices or actual performance by implementing recommendations made through the PART process. For example:

- The Broadcasting Board of Governors' efforts to broadcast to Near East Asia and South Asia could not demonstrate that they were achieving results last year. But following the recommendations in last year's PART, the program this year set goals for weekly audience, program quality, signal strength and cost-per-listener. With additional funding, the program dramatically increased its reach to Arab speaking countries to an estimated 10.5 million listeners each week, up from just 3.9 million in 2002.
- Last year, the Administration on Aging, which provides services and benefits to the elderly so they can remain in their homes and communities, could not measure its impact. This year, the program was able to show it was moderately effective after demonstrating that its services enable the elderly to remain in their homes and communities and setting goals for increasing the number of people served per each million dollars spent. With level funding, the program plans to increase by 6 percent in 2004 and 8 percent in 2005 the number of people served per million dollars in funding.
- The Department of Energy's (DOE) Advanced Scientific Computing Research program—which provides world-class scientific supercomputing facilities and funds research in applied mathematics, computer science, and networking—did not have a sufficient strategic vision or adequate performance measures in last year's PART. This year, the program has developed a strategic plan and has adopted performance measures that will focus on keeping its supercomputer hardware procurements on cost and schedule, and on making high-impact scientific advances by dedicating a substantial fraction of its supercomputing capacity to a small number of important, computationally intensive, large-scale research projects. These measures will routinely assess the usefulness and the

[1] Some reassessed programs were combined for review for the 2005 Budget, which is why the number of programs assessed for the 2004 Budget and the number of programs assessed for the 2005 Budget do not add up to exactly 400 programs.

efficiency of the facilities the program provides to scientists.

- The PART completed for the TRIO Upward Bound Program (Department of Education), which provides intensive services to improve academic performance and college preparation for high school students, found the program was inadequately targeted to the high-risk students who have potential for college but are not performing successfully in high school. In response, the Department of Education has created a special competition and awarded $19.2 million to projects that serve high-risk students. The Department will monitor the college enrollment rate for these participants and will use the results of this demonstration Initiative to guide future changes in the program.

What is the PART?

The PART is a questionnaire which consists of approximately 30 questions. It examines four critical areas of assessment—purpose and design, strategic planning, management, and results and accountability.

The first set of questions gauges whether the programs' design and purpose are clear and defensible. The second section involves strategic planning, and weighs whether the agency sets valid annual and long-term goals for programs. The third section rates agency management of programs, including financial oversight and program improvement efforts. The fourth set of questions focuses on results that programs can report with accuracy and consistency.

- The answers to questions in each of the four sections result in a numeric score for each section from 0 to 100 (100 being the best). These scores are then combined to achieve an overall qualitative rating of either Effective, Moderately Effective, Adequate, or Ineffective. Programs that do not have acceptable performance measures or have not yet collected performance data generally receive a rating of Results Not Demonstrated.
- The PART helps determine a program's strengths and weaknesses and focuses particularly on a program's performance. The PART is best seen as a complement to traditional management techniques, and can be used to stimulate a constructive dialogue between program managers, budget analysts, and policy officials. The PART serves its purpose if its findings and recommendations play a substantial role in spending, management and other decisions on programs.
- The PART was revised for the 2005 Budget to clarify the guidance and questions. The accompanying table provides a brief description of the four sections along with examples of programs that scored high or low in 2005. For more detailed information regarding PART guidance and PART worksheets, visit the OMB website at www.omb.gov/part.

Table 2–1. THE PART IN SECTIONS

Section	Description	Low Score Example	High Score Example
Program Purpose and Design Weight = 20 percent	To assess whether the program's purpose and design are clear and sound	USDA Direct Crops Payment Program—program design needs improvement to effectively reduce need for government income support	USDA Soil Survey Program—clear program; strong purpose commonly held by interested parties
Strategic Planning Weight = 10 percent	To assess whether the agency has established valid long-term and annual measures and targets for the program	EPA Brownfields Program—lacks strategic planning, ambitious goal setting	EPA Existing Chemicals Program—Long-term measures are outcome focused
Program Management Weight = 20 percent	To rate agency management of the program, including financial oversight and program improvement efforts	DOE Fusion Energy Sciences Program—program merit review processes yet to be validated for impact on quality and performance of the research portfolio	DOE Distributed Energy Resources Program—strong and responsive management and oversight
Program Results/Accountability Weight = 50 percent	To rate program performance on measures and targets reviewed in the strategic planning section through other evaluations	DOD Defense Health Program—no fully developed performance measures	DOD Energy Conservation Improvement Program—program achieves results, reduction in cost, net savings for investment

The following table illustrates some key questions from each section of the PART.

Table 2–2. THE PART QUESTIONNAIRE

Key Questions for Every Program	Description
PROGRAM PURPOSE AND DESIGN • Is the program purpose clear? • Does the program address a specific and existing problem, interest, or need? • Is the program designed so it is not redundant or duplicative of any other federal, state, local or private need? • Is the program designed free of major flaws that would limit program effectiveness? • Is the program effectively targeted, so that resources will reach the intended beneficiaries and/or otherwise address the program's purpose directly?	This section examines the clarity of program purpose and soundness of program design. It looks at factors including those the program, agency, or Administration may not directly control but which are within their influence, such as legislation and market factors. Programs should generally be designed to address a market failure—either an efficiency matter, such as a public good or externality, or a distributional objective, such as assisting low-income families—in the least costly or most efficient manner. A clear understanding of program purpose is essential to setting program goals, measures, and targets; maintaining focus; and managing the program. Potential source documents and evidence for answering questions in this section include authorizing legislation, agency strategic plans, annual performance plans, and other agency reports. Options for answers are *Yes, No or Not Applicable.*
STRATEGIC PLANNING • Does the program have a limited number of specific long-term performance measures that focus on outcomes and meaningfully reflect the purpose of the program? • Does the program have ambitious targets and timeframes for its long-term measures? • Does the program have a limited number of specific annual performance goals that can demonstrate progress toward achieving the program's long-term goals? • Does the program have baselines and ambitious targets for its annual measures? • Do all partners (grantees, sub-grantees, contractors, cost-sharing partners, and other government partners) commit to and work toward the annual and/or long-term goals of the program? • Are independent evaluations of sufficient scope conducted on a regular basis or as needed to support program improvements and evaluate effectiveness and relevance to the problem, interest or need? • Are Budget requests explicitly tied to accomplishment of the annual and long-term performance goals, and are the resource needs presented in a complete and transparent manner in the program's budget? • Has the program taken meaningful steps to address its strategic planning deficiencies?	This section focuses on program planning, priority setting, and resource allocation. Key elements include an assessment of whether the program has a limited number of performance measures with ambitious—yet achievable—targets, to ensure planning, management, and budgeting are strategic and focused. Potential source documents and evidence for answering questions include strategic planning documents, agency performance plans and reports, reports and submissions from program partners, evaluation plans, budget submissions and other program documents. Options for answers are *Yes, No* or *Not Applicable.*
PROGRAM MANAGEMENT • Does the agency regularly collect timely and credible performance information from key program partners, and use it to manage the program and improve performance? • Are Federal managers and program partners (including grantees, sub-grantees, contractors, cost-sharing partners, and other government partners) held accountable for cost, schedule and performance results? • Are funds (Federal and partners') obligated in a timely manner and spent for the intended purpose? • Does the program have procedures (i.e. competitive sourcing/cost comparisons, IT improvements, appropriate incentives) to measure and achieve efficiencies and cost effectiveness in program execution? • Does the program collaborate and coordinate effectively with related programs? • Does the program use strong financial management practices? • Has the program taken meaningful steps to address its management deficiencies?	This section focuses on a variety of elements related to whether the program is effectively managed to meet program performance goals. Key areas include financial oversight, evaluation of program improvements, performance data collection, and program manager accountability. Additionally, specific areas of importance for each program type are also explored. Potential source documents and evidence for answering questions in this section include financial statements, GAO reports, IG reports, performance plans, budget execution data, IT plans, and independent program evaluations. Options for answers are *Yes, No* or *Not Applicable.*
PROGRAM RESULTS • Has the program demonstrated adequate progress in achieving its long-term performance goal(s)? • Does the program (including program partners) achieve its annual performance goals? • Does the program demonstrate improved efficiencies or cost effectiveness in achieving program goals each year? • Does the performance of this program compare favorably to other programs, including government, private, etc., with similar purpose and goals? • Do independent evaluations of sufficient scope and quality indicate that the program is effective and achieving results?	This section considers whether a program is meeting its long-term and annual performance goals. This section also assesses how well the program compares to similar programs and how effective the program is based on independent evaluations. Potential source documents and evidence for answering questions in this section include annual performance reports, evaluations, GAO reports, IG reports and other agency documents. Assessments of program results should be based on the most recent reporting cycle or other relevant data. Answers in this section are rated as *Yes, Large Extent, Small Extent,* and *No.*

The PART segments mandatory and discretionary federal programs into seven categories. In addition to the questions which apply to all programs, each section includes questions that have been tailored for a specific type of program. A complete list of these questions is available at the OMB website. Table 2–3 describes the program categories.

Problems and Revisions

Since its inception, the PART has been improved annually based on feedback received from agencies and the public. Last year approximately 20 percent of programs were addressed using the PART, and for the 2005 Budget an additional 20 percent of programs were assessed. Those programs originally PARTed for the 2004 Budget were reassessed only where evidence showed an agency's rating was likely to change.

Changes to the PART centered on clarification of PART guidance and refinement of PART questions. Although all sections were revised to some degree, the strategic planning section received the bulk of the revision, having two key questions on long-term and annual performance measures enhanced to require more detailed information on appropriate measures and targets. Because of the strong focus on strategic planning and results and accountability, several questions in the two sections are linked. For instance, if a program was not able to demonstrate appropriate goals and targets in the strategic planning section, they were not given credit for measuring results against those targets in the performance results section. To alleviate this problem, agencies must improve the quality of the goals and targets arrived at through their strategic planning process.

This year's guidance was changed to include clarification on PART metrics. While the PART strives to focus on outcome performance measures, outputs can be appropriate practical measures in some cases. The 2005 guidance articulated the need for a high standard of justification for answers to receive a Yes. The completed PART is available to the public and as such, the review and its scores must be based on evidence.

For the 2005 Budget, PART worksheets were revised in order to produce a database of PART responses more effectively. PART responses across agencies are available at *www.whitehouse.gov/omb/budget/fy2005/pma.html.*

Possible Areas for Improvement

PART assessments will continue to be used for informing budget decisions, supporting management, identifying design problems, and promoting performance measurement and accountability. The performance of Government activities is sometimes difficult to measure and it will always be a challenge to assess the diversity of its programs in a uniform way. The Admin-

Table 2–3. THE PART, BY CATEGORY

Program Type	Description	Examples
Competitive Grant Programs	Programs that distribute funds to state, local and tribal governments, organizations, individuals and other entities through a competitive process	• Head Start • Weed and Seed
Block/Formula Grant Programs	Programs that distribute funds to state, local and tribal governments and other entities by formula or block grant	• Vocational Education State Grants • Native American Housing Block Grants
Regulatory-Based Programs	Programs that employ regulatory action to achieve program and agency goals through rulemaking that implements, interprets or prescribes law or policy, or describes procedure or practice requirements. These programs issue significant regulations, which are subject to OMB review	• Occupational Safety and Health Administration • Food Safety and Inspection Service
Capital Assets and Service Acquisition Programs	Programs where the primary means to achieve goals is the development and acquisition of capital assets (such as land, structures, equipment, and intellectual property) or the purchase of services (such as maintenance and information technology) from a commercial source	• Youth Anti-Drug Media Campaign • DOD—Shipbuilding
Credit Programs	Programs that provide support through loans, loan guarantees and direct credit	• Rural Electric Utility Loans and Guarantees
Direct Federal Programs	Programs in which support and services are provided primarily by federal employees	• Coin Production • National Weather Service
Research and Development Programs	Programs that focus on creating knowledge or applying it toward the creation of systems, devices, methods, materials or technologies	• Solar Energy • Mars Exploration

istration, however, is committed to assessing the performance of the Government's programs and to addressing and attempting to overcome the challenges associated with the effort.

One area that will require additional attention is the consistency among assessments. OMB will continue to promote consistency in the standards applied to PART assessments. This year the internal OMB Performance Evaluation Team again conducted a consistency check on PART worksheets. This review was then examined by the Performance Consortium of the National Academy of Public Administration. Recommendations for strengthening the PART review process for next year include adequately justifying explanations with evidence; explicitly addressing statutory barriers to improved performance; focusing on completed, not planned, actions; and rating new programs.

How the PARTs affect budget decisions

PART ratings do not result in automatic decisions about funding. Clearly, over time, funding should be targeted to programs that can prove they achieve measurable results. But a PART rating of Ineffective or Results Not Demonstrated may suggest that greater funding is necessary to overcome identified shortcomings, while a program rated Effective may be in line for a proposed funding decrease. For example:

- Although the Youth Activities program was rated "Ineffective," the program's proposed funding remains relatively stable. The program provides formula grants to States and local areas to provide training to low-income and other disadvantaged youth to help them secure employment, but does not have the authority to target funds to the areas of greatest need. To allow it to be more effective, the Administration proposes to give the Secretary of Labor and States increased authority to reallocate resources to areas of need.
- Despite the Department of Energy's Distributed Energy Resources Program's "Moderately Effective" rating, the Administration proposes a small reduction in funding for the program. The program funds research for improved energy efficiency of and reduced emissions from on-site energy production. The decrease in funding is attributable not to the program's rating, but to relative priorities among Department of Energy programs.

The following table lists summary PART results and funding information for each assessed program. It affirms the fact that PART ratings are one factor, but not the only factor, in the Administration's budget formulation process. The PART gives the Executive Branch, the Congress, and individual program managers valuable insight into ways we can improve program performance on behalf of the American people. Individual PART summaries are included on the CD that accompanies the Analytical Perspectives volume; full PART worksheets can be found on OMB's web page *www.whitehouse.gov/omb/budget/fy2005/pma.html.*

Table 2–4. PROGRAM ASSESSMENT RATING TOOL (PART)

(Current Data for All Programs Assessed by PART)[1]

Agency/ Program Title	Rating	Primary Program Type	Program Funding Level (dollars in millions)		
			2003 Actual	2004 Estimate	2005 Estimate
Department of Agriculture:					
Agricultural Credit Insurance Fund—Guaranteed Loans	Moderately Effective	Credit	3,080	2,416	2,866
Animal Welfare	Adequate	Regulatory Based	16	16	17
APHIS Plant and Animal Health Monitoring Programs	Effective	Regulatory Based	165	173	261
Bioenergy	Adequate	Direct Federal	116	150	100
CCC Marketing Loan Payments	Moderately Effective	Direct Federal	4,999	2,701	2,954
Community Facilities Program	Results Not Demonstrated	Credit	489	508	527
Conservation Technical Assistance	Results Not Demonstrated	Direct Federal	663	694	560
Crop Insurance	Results Not Demonstrated	Direct Federal	2,982	3,372	3,295
Direct Crop Payments	Adequate	Direct Federal	4,151	5,375	5,284
Farmland Protection Program	Results Not Demonstrated	Competitive Grant	78	101	121
Food Aid Programs	Results Not Demonstrated	Mixed	154	152	148
Food Safety and Inspection Service	Adequate	Regulatory Based	755	775	715
Food Safety Research	Results Not Demonstrated	Research and Development	95	97	106
Food Stamp Program	Moderately Effective	Block/Formula Grant	23,653	27,293	28,917
Forest Legacy Program (FLP)	Results Not Demonstrated	Competitive Grant	68	64	100
Forestry Research Grants	Results Not Demonstrated	Block/Formula Grant	22	22	22
Land Acquisition	Results Not Demonstrated	Direct Federal	133	67	67
Multifamily Housing Direct Loans and Rental Assistance	Results Not Demonstrated	Mixed	775	776	769
National Forest Improvement and Maintenance	Adequate	Capital Assets and Service Acquisition	548	559	505
National Resources Inventory	Results Not Demonstrated	Direct Federal	29	29	22
National School Lunch	Results Not Demonstrated	Block/Formula Grant	6,352	6,623	6,786

Table 2–4. PROGRAM ASSESSMENT RATING TOOL (PART)—Continued

(Current Data for All Programs Assessed by PART) [1]

Agency/ Program Title	Rating	Primary Program Type	Program Funding Level (dollars in millions)		
			2003 Actual	2004 Estimate	2005 Estimate
Pesticide Data/Microbiological Data Programs	Adequate	Direct Federal	22	21	21
Plant Materials Program	Results Not Demonstrated	Research and Development	11	11	10
RBS Business and Industry Guaranteed Loan Program	Adequate	Credit	894	556	600
Rural Electric Utility Loans and Guarantees	Results Not Demonstrated	Credit	4,069	3,989	2,640
Rural Utilities Service Telecommunications Loan Programs	Results Not Demonstrated	Credit	495	514	495
Rural Water and Wastewater Grants and Loans	Results Not Demonstrated	Mixed	1,596	1,628	1,475
Snow Survey and Water Supply Forecasting	Results Not Demonstrated	Direct Federal	9	9	9
Soil Survey Program	Moderately Effective	Direct Federal	85	86	87
USDA Wildland Fire Management	Results Not Demonstrated	Direct Federal	1,371	1,633	1,695
Wildlife Habitat Incentives Program	Results Not Demonstrated	Direct Federal	24	52	59
Department of Commerce:					
Advanced Technology Program	Adequate	Competitive Grant	179	171	....
Bureau of Economic Analysis	Effective	Direct Federal	65	67	82
Coastal Zone Management Act Programs	Results Not Demonstrated	Block/Formula Grant	129	113	111
Commerce Small Business Innovation Research (SBIR) Program	Results Not Demonstrated	Competitive Grant	8	4	....
Current Demographic Statistics	Moderately Effective	Direct Federal	54	58	61
Decennial Census	Moderately Effective	Direct Federal	145	253	433
Economic Development Administration	Moderately Effective	Competitive Grant	319	315	320
Intercensal Demographic Estimates	Moderately Effective	Direct Federal	9	9	11
Manufacturing Extension Partnership	Moderately Effective	Competitive Grant	106	39	39
Minority Business Development Agency	Results Not Demonstrated	Competitive Grant	29	29	34
National Marine Fisheries Service	Adequate	Regulatory Based	754	676	662
National Weather Service	Effective	Direct Federal	755	825	839
NIST Laboratories	Effective	Research and Development	423	401	482
NOAA Navigation Services	Moderately Effective	Direct Federal	70	74	73
Pacific Coastal Salmon Recovery Fund	Results Not Demonstrated	Block/Formula Grant	129	89	100
Survey Sample Redesign	Effective	Direct Federal	13	13	12
U.S. Patent and Trademark Office—Patents	Adequate	Direct Federal	1,053	1,090	1,371
U.S. Patent and Trademark Office—Trademarks	Moderately Effective	Direct Federal	129	132	162
US and Foreign Commercial Service (USFCS)	Adequate	Direct Federal	206	202	212
Department of Defense—Military:					
Air Combat Program	Moderately Effective	Capital Assets and Service Acquisition	15,149	16,023	16,457
Airlift Program	Moderately Effective	Capital Assets and Service Acquisition	5,300	4,798	5,937
Basic Research	Effective	Research and Development	1,369	1,404	1,341
Chemical Demilitarization	Ineffective	Capital Assets and Service Acquisition	1,449	1,650	1,457
Comanche Helicopter Program	Results Not Demonstrated	Capital Assets and Service Acquisition	877	1,079	1,252
Communications Infrastructure	Results Not Demonstrated	Capital Assets and Service Acquisition	5,600	6,273	6,276
Defense Health	Adequate	Direct Federal	15,398	16,392	17,640
DoD Small Business Innovation Research/ Technology Transfer	Results Not Demonstrated	Research and Development	963	1,100	1,133
Energy Conservation Improvement	Effective	Capital Assets and Service Acquisition	35	50	60
Facilities Sustainment, Restoration, Modernization, and Demolition	Adequate	Direct Federal	6,620	6,424	6,643
Housing	Moderately Effective	Direct Federal	13,683	14,230	15,672
Military Force Management	Effective	Direct Federal	93,500	98,956	103,100
Missile Defense	Results Not Demonstrated	Capital Assets and Service Acquisition	7,490	9,095	10,298
Recruiting	Moderately Effective	Direct Federal	2,404	2,369	2,361
Shipbuilding	Adequate	Capital Assets and Service Acquisition	9,457	12,201	11,477
Department of Education:					
21st Century Community Learning Centers	Adequate	Block/Formula Grant	993	999	999

Table 2–4. PROGRAM ASSESSMENT RATING TOOL (PART)—Continued

(Current Data for All Programs Assessed by PART) [1]

Agency/ Program Title	Rating	Primary Program Type	Program Funding Level (dollars in millions)		
			2003 Actual	2004 Estimate	2005 Estimate
Adult Education State Grants	Results Not Demonstrated	Block/Formula Grant	587	590	590
Comprehensive School Reform	Adequate	Block/Formula Grant	233	234	....
Even Start	Ineffective	Block/Formula Grant	248	247	....
Federal Family Education Loans	Adequate	Credit	3,432	2,880	7,050
Federal Pell Grants	Adequate	Block/Formula Grant	11,365	12,007	12,830
Federal Perkins Loans	Ineffective	Credit	99	99	....
Federal Work-Study	Results Not Demonstrated	Block/Formula Grant	999	999	999
GEAR UP	Adequate	Competitive Grant	293	298	298
IDEA Grants for Infants and Families	Results Not Demonstrated	Block/Formula Grant	434	444	467
IDEA Grants to States	Results Not Demonstrated	Block/Formula Grant	8,874	10,068	11,068
IDEA Part D—Personnel Preparation	Results Not Demonstrated	Competitive Grant	92	91	91
IDEA Part D—Research and Innovation	Results Not Demonstrated	Research and Development	77	78	78
IDEA Preschool Grants	Results Not Demonstrated	Block/Formula Grant	387	388	388
Improving Teacher Quality State Grants	Results Not Demonstrated	Block/Formula Grant	2,931	2,930	2,930
Independent Living (IL) Programs	Results Not Demonstrated	Competitive Grant	85	96	96
National Assessment	Effective	Research and Development	95	95	95
National Center for Education Statistics	Effective	Research and Development	89	92	92
Nat'l Institute on Disability and Rehab. Research (NIDRR)	Results Not Demonstrated	Research and Development	109	107	107
Occupational and Employment Information	Results Not Demonstrated	Competitive Grant	9	9	....
Safe and Drug Free Schools State Grants	Ineffective	Block/Formula Grant	469	441	441
Student Aid Administration	Adequate	Capital Assets and Service Acquisition	900	912	935
Supplemental Educational Opportunity Grants	Results Not Demonstrated	Block/Formula Grant	760	770	770
Teacher Quality Enhancement	Results Not Demonstrated	Competitive Grant	89	89	89
Tech-Prep Education State Grants	Results Not Demonstrated	Block/Formula Grant	107	107	....
Tribally Controlled Postsecondary Vocational and Technical Institutions	Results Not Demonstrated	Competitive Grant	7	7	7
TRIO Student Support Services	Results Not Demonstrated	Competitive Grant	264	264	267
TRIO Talent Search	Results Not Demonstrated	Competitive Grant	145	146	146
TRIO Upward Bound	Ineffective	Competitive Grant	279	282	281
Troops-to-Teachers	Adequate	Competitive Grant	29	15	15
Vocational Education State Grants	Ineffective	Block/Formula Grant	1,192	1,195	1,012
Vocational Rehabilitation State Grants	Adequate	Block/Formula Grant	2,533	2,584	2,636
William D. Ford Direct Student Loans	Adequate	Credit	4,225	2,381	–492
Department of Energy:					
Advanced Fuel Cycle Initiative	Moderately Effective	Research and Development	57	67	46
Advanced Scientific Computing Research	Moderately Effective	Research and Development	167	202	204
Advanced Simulation and Computing (ASCI)	Effective	Research and Development	674	721	741
Basic Energy Sciences	Effective	Research and Development	1,020	1,011	1,064
Biological and Environmental Research	Effective	Research and Development	507	641	502
Bonneville Power Administration	Moderately Effective	Capital Assets and Service Acquisition	–462	–30	–10
Building Technologies	Adequate	Research and Development	67	60	58
Clean Coal Research Initiative	Adequate	Research and Development	345	378	447
Distributed Energy Resources	Moderately Effective	Research and Development	61	61	53
Elimination of Weapons-Grade Plutonium Production Program	Results Not Demonstrated	Capital Assets and Service Acquisition	122	50	50
Environmental Management	Adequate	Capital Assets and Service Acquisition	6,952	7,034	7,434
Facilities and Infrastructure	Moderately Effective	Capital Assets and Service Acquisition	235	239	316
Fuel Cells (Stationary)	Adequate	Research and Development	61	71	23
Fusion Energy Sciences	Moderately Effective	Research and Development	247	263	264
Generation IV Nuclear Energy Systems Initiative	Moderately Effective	Research and Development	17	24	31
Geothermal Technology	Moderately Effective	Research and Development	29	26	26
High Energy Physics	Moderately Effective	Research and Development	718	734	737
High Temperature Superducting R&D	Moderately Effective	Research and Development	39	34	45
Hydrogen Technology	Moderately Effective	Research and Development	39	82	95
Inertial Confinement Fusion Ignition and High Yield Campaign/NIF Construction Project	Moderately Effective	Research and Development	499	514	492

Table 2–4. PROGRAM ASSESSMENT RATING TOOL (PART)—Continued

(Current Data for All Programs Assessed by PART) [1]

Agency/ Program Title	Rating	Primary Program Type	Program Funding Level (dollars in millions)		
			2003 Actual	2004 Estimate	2005 Estimate
International Nuclear Materials Protection and Cooperation	Effective	Direct Federal	333	258	238
Natural Gas Technologies	Ineffective	Research and Development	47	43	26
Nuclear Energy Research Initiative	Results Not Demonstrated	Research and Development	17	11	....
Nuclear Physics	Effective	Research and Development	380	390	401
Nuclear Power 2010	Adequate	Research and Development	32	20	10
Oil Technology	Ineffective	Research and Development	42	35	15
Readiness in Technical Base and Facilities (RTBF), Operations	Moderately Effective	Capital Assets and Service Acquisition	996	1,022	1,018
Safeguards and Security	Adequate	Capital Assets and Service Acquisition	529	553	667
Solar Energy	Moderately Effective	Research and Development	84	83	80
Southeastern Power Administration	Moderately Effective	Direct Federal	5	5	5
Southwestern Power Administration	Moderately Effective	Direct Federal	27	28	29
Strategic Petroleum Reserve (SPR)	Effective	Direct Federal	172	171	172
Weatherization Assistance	Moderately Effective	Block/Formula Grant	224	227	291
Western Area Power Administration	Moderately Effective	Capital Assets and Service Acquisition	168	177	173
Wind Energy	Moderately Effective	Research and Development	42	41	42
Yucca Mountain Project	Adequate	Capital Assets and Service Acquisition	457	577	880
Department of Health and Human Services:					
317 Immunization Program	Adequate	Competitive Grant	651	643	534
Administration on Aging	Moderately Effective	Block/Formula Grant	1,367	1,374	1,377
Agency for Toxic Substances and Disease Registry	Adequate	Competitive Grant	82	73	77
CDC State and Local Preparedness Grants	Results Not Demonstrated	Block/Formula Grant	939	934	829
Children’s Hospitals Graduate Medical Education Payment Program	Adequate	Block/Formula Grant	290	303	303
Childrens Mental Health Services	Moderately Effective	Competitive Grant	98	102	106
Chronic Disease—Breast and Cervical Cancer	Adequate	Competitive Grant	199	210	220
Chronic Disease—Diabetes	Adequate	Competitive Grant	63	67	67
Community Mental Health Services Block Grant	Adequate	Block/Formula Grant	437	435	436
Community Services Block Grant	Results Not Demonstrated	Block/Formula Grant	646	642	495
Data Collection and Dissemination	Moderately Effective	Research and Development	62	67	64
Developmental Disabilities Grant Programs	Adequate	Block/Formula Grant	132	138	138
Domestic HIV/AIDS Prevention	Results Not Demonstrated	Competitive Grant	700	695	696
Food and Drug Administration	Moderately Effective	Regulatory Based	1,652	1,695	1,845
Foster Care	Adequate	Block/Formula Grant	4,451	4,706	4,871
Head Start	Results Not Demonstrated	Competitive Grant	6,687	6,775	6,944
Health Alert Network	Adequate	Competitive Grant	183	183	183
Health Care Fraud and Abuse Control (HCFAC)	Results Not Demonstrated	Direct Federal	160	160	160
Health Centers	Effective	Competitive Grant	1,505	1,617	1,836
Health Professions	Ineffective	Competitive Grant	401	409	126
HIV/AIDS Research	Moderately Effective	Research and Development	2,716	2,850	2,930
Hospital Preparedness Grants	Results Not Demonstrated	Block/Formula Grant	515	515	476
IHS Federally-Administered Activities	Moderately Effective	Direct Federal	1,346	1,378	1,408
IHS Sanitation Facilities Construction Program	Moderately Effective	Capital Assets and Service Acquisition	93	93	103
Low Income Home Energy Assistance Program	Results Not Demonstrated	Block/Formula Grant	1,788	1,900	2,001
Maternal and Child Health Block Grant (MCHBG)	Moderately Effective	Block/Formula Grant	730	730	730
Medicare	Moderately Effective	Direct Federal	277,464	298,916	326,716
Medicare Integrity Program (HCFAC)	Effective	Block/Formula Grant	720	720	720
National Health Service Corps	Moderately Effective	Competitive Grant	171	170	205
Nursing Education Loan Repayment and Scholarship Program	Adequate	Competitive Grant	20	27	32
Office of Child Support Enforcement	Effective	Block/Formula Grant	3,845	4,413	4,074
Patient Safety	Adequate	Research and Development	55	80	84

Table 2–4. PROGRAM ASSESSMENT RATING TOOL (PART)—Continued

(Current Data for All Programs Assessed by PART) [1]

Agency/ Program Title	Rating	Primary Program Type	Program Funding Level (dollars in millions)		
			2003 Actual	2004 Estimate	2005 Estimate
Projects for Assistance in Transition from Homelessness	Moderately Effective	Block/Formula Grant	43	50	55
Refugee and Entrant Assistance	Adequate	Block/Formula Grant	481	448	473
Resource and Patient Management System	Effective	Capital Assets and Service Acquisition	58	65	70
Runaway and Homeless Youth	Results Not Demonstrated	Competitive Grant	105	105	105
Rural Health Activities	Adequate	Competitive Grant	184	147	56
Ryan White	Adequate	Block/Formula Grant	1,993	2,020	2,055
State Children's Health Insurance Program	Adequate	Block/Formula Grant	4,355	5,232	5,299
Substance Abuse Prevention and Treatment Block Grant	Ineffective	Block/Formula Grant	1,754	1,779	1,832
Substance Abuse Treatment Programs of Regional and National Significance	Adequate	Competitive Grant	317	419	517
Translating Research into Practice	Adequate	Research and Development	10	8	5
Urban Indian Health Program	Adequate	Block/Formula Grant	31	32	32
Department of Homeland Security:					
Aids to Navigation	Results Not Demonstrated	Direct Federal	805	808	855
Assistance to Firefighters Grant Program	Results Not Demonstrated	Competitive Grant	745	746	500
Aviation Passenger Screening Program	Results Not Demonstrated	Direct Federal	1,875	1,531	1,586
Border Patrol	Results Not Demonstrated	Direct Federal	1,981	1,847	1,862
Coast Guard Fisheries Enforcement	Moderately Effective	Direct Federal	533	688	704
Container Security Initiative	Results Not Demonstrated	Direct Federal	48	62	126
Detention and Removal	Moderately Effective	Direct Federal	1,150	1,130	1,259
Disaster Relief Fund—Public Assistance	Results Not Demonstrated	Direct Federal	1,113	1,037	1,075
Drug Interdiction	Results Not Demonstrated	Direct Federal	648	774	822
Federal Air Marshal Service	Results Not Demonstrated	Direct Federal	537	640	613
Federal Law Enforcement Training Center	Results Not Demonstrated	Direct Federal	171	192	196
Federal Protective Service	Moderately Effective	Direct Federal	448	424	478
Hazard Mitigation Grant	Results Not Demonstrated	Block/Formula Grant	167	155	161
Immigration Services	Adequate	Direct Federal	1,425	1,653	1,711
Marine Environmental Protection	Moderately Effective	Regulatory Based	145	252	267
Metropolitan Medical Response System	Results Not Demonstrated	Block/Formula Grant	50	50	....
National Flood Insurance	Moderately Effective	Direct Federal	1,655	1,719	1,787
Search and Rescue	Results Not Demonstrated	Direct Federal	591	842	891
Department of Housing and Urban Development:					
Community Development Block Grant (Formula)	Ineffective	Block/Formula Grant	4,340	4,331	4,331
HOME Investment Partnerships Program	Moderately Effective	Block/Formula Grant	1,987	2,006	2,084
HOPE VI	Ineffective	Competitive Grant	570	149	....
Housing for Persons with Disabilities	Results Not Demonstrated	Competitive Grant	249	250	249
Housing for the Elderly	Results Not Demonstrated	Competitive Grant	778	774	773
Housing Opportunities for Persons with AIDS	Results Not Demonstrated	Block/Formula Grant	290	295	295
Housing Vouchers	Moderately Effective	Competitive Grant	12,458	14,602	13,364
Lead Hazard Grants	Moderately Effective	Competitive Grant	165	164	129
National Community Development Initiative	Moderately Effective	Block/Formula Grant	32	35	30
Native American Housing Block Grants	Results Not Demonstrated	Block/Formula Grant	645	650	647
Partnership for Advancing Technology in Housing (PATH)	Results Not Demonstrated	Research and Development	8	8	2
Project-Based Rental Assistance	Ineffective	Capital Assets and Service Acquisition	4,766	4,769	5,102
Department of the Interior:					
Abandoned Mine Land Reclamation	Results Not Demonstrated	Block/Formula Grant	190	191	244
DOI Wildland Fire Management	Results Not Demonstrated	Direct Federal	650	685	743
Energy and Minerals Management	Adequate	Direct Federal	106	108	108
Energy Resource Assessments	Moderately Effective	Research and Development	24	25	25
Geologic Hazard Assessments	Moderately Effective	Research and Development	75	75	74
Habitat Restoration Activities	Moderately Effective	Direct Federal	145	147	147
Indian Forestry Program	Adequate	Direct Federal	49	52	53
Indian Law Enforcement	Results Not Demonstrated	Direct Federal	162	172	182
Indian School Construction	Results Not Demonstrated	Capital Assets and Service Acquisition	294	295	229
Indian School Operations	Adequate	Direct Federal	513	522	522

Table 2–4. PROGRAM ASSESSMENT RATING TOOL (PART)—Continued

(Current Data for All Programs Assessed by PART) [1]

Agency/ Program Title	Rating	Primary Program Type	Program Funding Level (dollars in millions)		
			2003 Actual	2004 Estimate	2005 Estimate
Land & Water Conservation Fund (LWCF) State Grants	Results Not Demonstrated	Block/Formula Grant	97	94	94
Mineral Resource Assessments	Moderately Effective	Research and Development	56	55	49
Minerals Revenue Management	Results Not Demonstrated	Direct Federal	83	80	82
National Fish Hatchery System	Results Not Demonstrated	Mixed	54	58	57
National Historic Preservation Programs	Moderately Effective	Block/Formula Grant	88	93	97
National Mapping	Results Not Demonstrated	Research and Development	133	130	128
National Park Service Facility Management	Adequate	Capital Assets and Service Acquisition	657	700	725
National Park Service Natural Resource Stewardship	Moderately Effective	Direct Federal	191	198	205
National Wildlife Refuge Operations and Maintenance	Results Not Demonstrated	Direct Federal	368	391	388
Outer Continental Shelf Environmental Studies	Moderately Effective	Research and Development	16	16	16
Partners for Fish and Wildlife	Adequate	Direct Federal	38	42	50
Reclamation Hydropower	Effective	Capital Assets and Service Acquisition	145	148	159
Recreation Management	Adequate	Direct Federal	58	61	59
Regulation of Surface Coal Mining Activities	Results Not Demonstrated	Regulatory Based	105	105	109
Rural Water Supply Projects	Results Not Demonstrated	Capital Assets and Service Acquisition	80	83	68
Science & Technology Program (S&T)	Effective	Research and Development	13	16	10
Title XVI Water Reuse and Recycling	Moderately Effective	Competitive Grant	32	28	12
Tribal Courts	Results Not Demonstrated	Direct Federal	17	18	18
Tribal Land Consolidation	Moderately Effective	Capital Assets and Service Acquisition	8	22	75
Department of Justice:					
ATF Firearms Programs—Integrated Violence Reduction Strategy	Moderately Effective	Direct Federal	601	615	632
Bureau of Prisons	Moderately Effective	Direct Federal	4,045	4,414	4,517
Community Oriented Policing Services	Results Not Demonstrated	Competitive Grant	978	742	44
Cybercrime	Adequate	Direct Federal	157	206	265
Drug Courts	Results Not Demonstrated	Competitive Grant	45	38	70
Drug Enforcement Administration	Adequate	Direct Federal	1,802	1,677	1,797
Juvenile Accountability Block Grants	Ineffective	Block/Formula Grant	189	59	....
National Criminal History Improvement Program	Moderately Effective	Block/Formula Grant	40	30	58
Organized Crime/Drug Enforcement	Adequate	Direct Federal	478	495	512
Residential Substance Abuse Treatment	Results Not Demonstrated	Block/Formula Grant	65	....	76
State Criminal Alien Assistance Program	Results Not Demonstrated	Block/Formula Grant	248	297	....
USMS Apprehension of Fugitives	Adequate	Direct Federal	180	180	184
USMS Protection of the Judicial Process	Adequate	Direct Federal	514	540	554
Weed and Seed	Results Not Demonstrated	Competitive Grant	59	58	58
White Collar Crime	Adequate	Direct Federal	474	512	509
Department of Labor:					
Black Lung Benefits Program	Moderately Effective	Direct Federal	1,461	1,452	1,423
Bureau of Labor Statistics	Effective	Direct Federal	492	519	532
Community Service Employment for Older Americans	Ineffective	Direct Federal	442	439	440
Davis-Bacon Wage Determination Program	Results Not Demonstrated	Regulatory Based	10	10	10
Dislocated Worker Assistance	Adequate	Block/Formula Grant	1,150	1,173	1,106
Employee Benefits Security Administration (EBSA)	Results Not Demonstrated	Regulatory Based	116	124	132
Federal Employees Compensation Act (FECA)	Moderately Effective	Direct Federal	2,475	2,558	2,631
Migrant and Seasonal Farmworkers	Ineffective	Competitive Grant	77	77	....
Mine Safety and Health Administration	Adequate	Regulatory Based	273	269	276
Occupational Safety and Health Administration	Adequate	Regulatory Based	450	458	462
Office of Federal Contract Compliance Programs (OFCCP)	Results Not Demonstrated	Regulatory Based	78	79	82
Trade Adjustment Assistance	Ineffective	Direct Federal	972	1,338	1,057
Unemployment Insurance Administration State Grants	Moderately Effective	Block/Formula Grant	2,634	2,619	2,711

Table 2–4. PROGRAM ASSESSMENT RATING TOOL (PART)—Continued

(Current Data for All Programs Assessed by PART) [1]

Agency/ Program Title	Rating	Primary Program Type	Program Funding Level (dollars in millions)		
			2003 Actual	2004 Estimate	2005 Estimate
Youth Activities	Ineffective	Block/Formula Grant	994	995	1,001
Department of State:					
Anti-Terrorism Assistance	Effective	Direct Federal	64	96	128
Capital Security Construction Program	Effective	Capital Assets and Service Acquisition	608	761	888
Contribution to the United Nations Development Programme (UNDP)	Results Not Demonstrated	Block/Formula Grant	100	100	90
Demining	Effective	Direct Federal	45	50	59
Educational and Cultural Exchange Programs in Near East Asia and South Asia	Effective	Competitive Grant	49	49	60
Humanitarian Migrants to Israel	Moderately Effective	Block/Formula Grant	60	50	50
Military Assistance to new NATO and NATO Aspirant Nations	Moderately Effective	Direct Federal	99	95	22
Nonproliferation and Disarmament Fund	Results Not Demonstrated	Direct Federal	15	30	30
PKO—OSCE Programs	Moderately Effective	Direct Federal	18	32	3
Refugee Admissions to the U.S	Moderately Effective	Competitive Grant	113	136	136
Security Assistance for the Western Hemisphere	Moderately Effective	Direct Federal	124	158	124
Security Assistance to Sub-Saharan Africa	Moderately Effective	Direct Federal	102	60	96
Support for Eastern European Democracy & Freedom Support Act	Results Not Demonstrated	Competitive Grant	1,277	1,026	950
Terrorist Interdiction Program (TIP)	Results Not Demonstrated	Direct Federal	5	5	5
UN High Commissioner for Refugees (UNHCR)	Moderately Effective	Block/Formula Grant	303	310	229
Visa and Consular Services	Moderately Effective	Direct Federal	664	807	865
Worldwide Security Upgrades	Moderately Effective	Direct Federal	553	647	659
Department of Transportation:					
FAA Air Traffic Services	Adequate	Direct Federal	5,666	6,097	6,522
FAA Grants-in-Aid for Airports (Airport Improvement Program)	Moderately Effective	Competitive Grant	3,378	3,400	3,500
Federal Lands	Moderately Effective	Block/Formula Grant	773	767	947
Federal Motor Carrier Safety Administration Grant Program	Moderately Effective	Block/Formula Grant	164	165	168
FHWA Highway Infrastructure	Moderately Effective	Block/Formula Grant	29,847	32,462	32,138
Hazardous Materials Transportation	Moderately Effective	Block/Formula Grant	14	14	14
National Highway Traffic Safety Administration Grant Program	Moderately Effective	Block/Formula Grant	446	449	456
New Starts	Moderately Effective	Competitive Grant	1,275	1,356	1,599
Railroad Safety Program (RSP)	Moderately Effective	Regulatory Based	115	129	138
Research, Engineering & Development	Effective	Research and Development	163	113	117
Department of the Treasury:					
Administering the Public Debt	Effective	Direct Federal	189	174	175
African Development Fund	Results Not Demonstrated	Block/Formula Grant	107	112	118
ATF Consumer Product Safety Activities	Adequate	Regulatory Based	23	23	23
Bank Enterprise Award	Results Not Demonstrated	Competitive Grant	18	9	5
Coin Production	Effective	Direct Federal	311	431	441
Debt Collection	Effective	Direct Federal	48	47	47
Earned Income Tax Credit (EITC) Compliance	Ineffective	Direct Federal	145	201	176
International Development Association	Adequate	Block/Formula Grant	844	977	1,068
IRS Tax Collection	Results Not Demonstrated	Direct Federal	957	1,002	1,083
New Currency Manufacturing	Effective	Direct Federal	90	325	400
OCC Bank Supervision	Effective	Regulatory Based	439	477	488
Office of Foreign Assets Control (OFAC)	Results Not Demonstrated	Direct Federal	20	21	22
OTS Thrift Supervision	Effective	Regulatory Based	158	174	178
Submission Processing (SP)	Results Not Demonstrated	Direct Federal	721	726	734
Treasury Technical Assistance	Adequate	Direct Federal	33	19	18
Department of Veterans Affairs:					
Burial Benefits	Moderately Effective	Direct Federal	397	431	455
Disability Compensation	Results Not Demonstrated	Direct Federal	25,385	27,712	32,266
Medical Care	Adequate	Direct Federal	25,348	28,297	29,471
Montgomery GI Bill (MGIB) (Education Benefits)	Results Not Demonstrated	Direct Federal	1,776	1,988	2,112
VA Research and Development	Results Not Demonstrated	Research and Development	818	820	770

Table 2–4. PROGRAM ASSESSMENT RATING TOOL (PART)—Continued

(Current Data for All Programs Assessed by PART)[1]

Agency/ Program Title	Rating	Primary Program Type	Program Funding Level (dollars in millions)		
			2003 Actual	2004 Estimate	2005 Estimate
Corps of Engineers-Civil Works:					
Corps Hydropower	Results Not Demonstrated	Capital Assets and Service Acquisition	252	245	220
Emergency Management	Moderately Effective	Direct Federal	75	....	50
Flood Damage Reduction	Results Not Demonstrated	Capital Assets and Service Acquisition	1,011	972	930
Inland Waterways Navigation	Results Not Demonstrated	Capital Assets and Service Acquisition	715	690	630
Non-regulatory Wetlands Activities	Results Not Demonstrated	Capital Assets and Service Acquisition	279	260	300
USACE Regulatory Program	Moderately Effective	Regulatory Based	138	139	150
Environmental Protection Agency:					
Acid Rain	Moderately Effective	Regulatory Based	17	17	17
Air Toxics	Results Not Demonstrated	Direct Federal	100	113	113
Brownfields	Adequate	Competitive Grant	167	170	210
Civil Enforcement	Results Not Demonstrated	Direct Federal	431	448	456
Clean Water State Revolving Fund	Results Not Demonstrated	Block/Formula Grant	1,341	1,342	850
Criminal Enforcement	Results Not Demonstrated	Direct Federal	40	42	43
Drinking Water State Revolving Fund	Results Not Demonstrated	Block/Formula Grant	850	845	850
Ecological Research	Results Not Demonstrated	Research and Development	132	132	110
Environmental Education	Results Not Demonstrated	Competitive Grant	9	9	....
Existing Chemicals	Adequate	Direct Federal	16	17	17
Leaking Underground Storage Tanks	Results Not Demonstrated	Block/Formula Grant	72	76	73
New Chemicals	Moderately Effective	Direct Federal	15	15	15
Nonpoint Source Grants	Results Not Demonstrated	Block/Formula Grant	237	195	209
Particulate Matter Research	Results Not Demonstrated	Research and Development	61	65	65
Pesticide Registration	Adequate	Direct Federal	45	66	66
Pesticide Reregistration	Results Not Demonstrated	Direct Federal	72	77	83
Pollution Prevention and New Technologies	Results Not Demonstrated	Research and Development	49	42	36
RCRA Corrective Action	Adequate	Regulatory Based	35	39	39
Superfund Removal	Results Not Demonstrated	Direct Federal	196	200	183
Tribal General Assistance	Adequate	Block/Formula Grant	57	62	62
General Services Administration:					
Asset Management of Federally-Owned Real Property	Results Not Demonstrated	Capital Assets and Service Acquisition	1,754	1,805	1,819
GSA's Regional IT Solutions Program	Results Not Demonstrated	Capital Assets and Service Acquisition	5,810	6,080	6,282
Leasing Space	Results Not Demonstrated	Capital Assets and Service Acquisition	3,467	3,641	4,018
Multiple Award Schedules	Results Not Demonstrated	Direct Federal	414	420	443
Personal Property Management Program (FBP)	Results Not Demonstrated	Direct Federal	26	27	27
Real Property Disposal (PR)	Results Not Demonstrated	Direct Federal	32	40	44
Supply Depots and Special Order	Results Not Demonstrated	Capital Assets and Service Acquisition	993	847	856
Vehicle Acquisition	Results Not Demonstrated	Capital Assets and Service Acquisition	1,227	1,216	1,199
Vehicle Leasing	Results Not Demonstrated	Capital Assets and Service Acquisition	1,230	1,447	1,569
National Aeronautics and Space Administration:					
Biological Sciences Research	Results Not Demonstrated	Research and Development	269	368	492
Earth Science Applications	Results Not Demonstrated	Research and Development	78	91	77
Mars Exploration	Effective	Research and Development	500	595	691
Mission and Science Measurement Technology	Moderately Effective	Research and Development	304	467	1,094
Solar System Exploration	Effective	Research and Development	1,039	1,316	1,187
Space Shuttle	Results Not Demonstrated	Capital Assets and Service Acquisition and Service Acquisition	3,301	3,945	4,319
Space Station	Results Not Demonstrated	Capital Assets and Service Acquisition	1,462	1,498	1,863
National Science Foundation:					
Facilities	Effective	Research and Development	527	612	683

Table 2–4. PROGRAM ASSESSMENT RATING TOOL (PART)—Continued

(Current Data for All Programs Assessed by PART) [1]

Agency/ Program Title	Rating	Primary Program Type	Program Funding Level (dollars in millions)		
			2003 Actual	2004 Estimate	2005 Estimate
Individuals	Effective	Research and Development	417	447	498
Information Technology Research	Effective	Research and Development	299	313	220
Nanoscale Science and Engineering	Effective	Research and Development	221	249	305
Small Business Administration:					
Business Information Centers	Results Not Demonstrated	Direct Federal	14	14	....
Disaster Loan Program	Moderately Effective	Credit	190	169	197
Section 504 Certified Development Company Guaranteed Loan Program	Adequate	Credit	13	17	14
Service Corps of Retired Executives	Moderately Effective	Block/Formula Grant	9	14	12
Small Business Development Centers	Moderately Effective	Block/Formula Grant	95	98	103
Small Business Investment Company	Adequate	Credit	13	13	13
Social Security Administration:					
Disability Insurance	Moderately Effective	Direct Federal	71,523	78,645	84,119
Supplemental Security Income for the Aged	Moderately Effective	Direct Federal	4,208	4,298	4,652
International Assistance Programs					
Broadcasting Board of Governors:					
Broadcasting to Africa	Moderately Effective	Direct Federal	15	13	14
Broadcasting to Near East Asia and South Asia	Moderately Effective	Direct Federal	88	128	95
Export-Import Bank of the United States:					
Export Import Bank—Long Term Guarantees	Moderately Effective	Credit	564	55	156
Overseas Private Investment Corporation:					
Overseas Private Investment Corporation—Finance	Adequate	Credit	24	24	24
Overseas Private Investment Corporation—Insurance	Adequate	Credit	1,753	1,800	2,000
Trade and Development Agency:					
U.S. Trade and Development Agency	Moderately Effective	Competitive Grant	58	50	50
United States Agency for International Development:					
Child Survival and Health (LAC)	Results Not Demonstrated	Competitive Grant	158	154	137
Development Assistance	Results Not Demonstrated	Competitive Grant	261	268	242
Office of Transition Initiatives	Moderately Effective	Competitive Grant	50	55	63
Public Law 480 Title II Food Aid	Adequate	Competitive Grant	1,441	1,185	1,185
USAID Climate Change	Adequate	Competitive Grant	214	175	155
USAID Development Assistance—Population	Moderately Effective	Competitive Grant	444	430	425
Other Independent Agencies					
American Battle Monuments Commission:					
World War II Memorial	Effective	Capital Assets and Service Acquisition	76	55	22
Armed Forces Retirement Home:					
Asset Management of AFRH Real Property	Moderately Effective	Capital Assets and Service Acquisition	68	65	61
Consumer Product Safety Commission:					
Consumer Product Safety Commission	Results Not Demonstrated	Regulatory Based	57	60	63
Corporation for National and Community Service:					
AmeriCorps	Results Not Demonstrated	Competitive Grant	174	312	292
Federal Communications Commission:					
Schools and Libraries—Universal Service Fund	Results Not Demonstrated	Regulatory Based	2,250	2,250	2,250
Federal Election Commission:					
Compliance—Enforcement	Results Not Demonstrated	Regulatory Based	50	51	52
National Archives and Records Administration:					
Records Services Program	Adequate	Direct Federal	332	374	391
Nuclear Regulatory Commission:					
Fuel Facilities Licensing & Inspection	Effective	Regulatory Based	14	16	26
Reactor Inspection and Performance Assessment	Effective	Regulatory Based	97	96	157
Office of National Drug Control Policy:					
CTAC Counterdrug Research & Development	Results Not Demonstrated	Research and Development	22	18	18

Table 2–4. PROGRAM ASSESSMENT RATING TOOL (PART)—Continued

(Current Data for All Programs Assessed by PART) [1]

Agency/ Program Title	Rating	Primary Program Type	Program Funding Level (dollars in millions)		
			2003 Actual	2004 Estimate	2005 Estimate
CTAC Technology Transfer Program	Results Not Demonstrated	Competitive Grant	26	22	22
Drug-Free Communities Support Program	Adequate	Competitive Grant	60	70	80
High Intensity Drug Trafficking Areas (HIDTA)	Results Not Demonstrated	Competitive Grant	226	226	208
Youth Anti-Drug Media Campaign	Results Not Demonstrated	Capital Assets and Service Acquisition	150	145	145
Office of Personnel Management:					
Federal Employees Group Life Insurance (FEGLI)	Results Not Demonstrated	Direct Federal	2,022	2,069	2,164
Federal Employees Retirement Program	Results Not Demonstrated	Direct Federal	50,512	53,092	55,210
FEHBP Integrity	Effective	Direct Federal	8	11	15
Public Defender Service for the District of Columbia:					
Public Defender Service for the District of Columbia	Results Not Demonstrated	Direct Federal	23	25	30
Securities and Exchange Commission:					
Full Disclosure Program (Corporate Review)	Results Not Demonstrated	Regulatory Based	44	61	79
Tennessee Valley Authority:					
TVA Power	Moderately Effective	Capital Assets and Service Acquisition	7,585	7,474	7,579
TVA Resource Stewardship (Non-Power)	Effective	Capital Assets and Service Acquisition	83	84	83

[1] If a program definition changed between the 2004 Budget and the 2005 Budget, only the program that was most recently PARTed is listed.

CROSSCUTTING PROGRAMS

3. HOMELAND SECURITY FUNDING ANALYSIS

Since the terrorist attacks of September 11, 2001, America has engaged in a broad, determined effort to thwart terrorism. The Administration has worked with the Congress to enact landmark legislation to reorganize the Federal Government, improve intelligence capabilities, acquire countermeasures to biological weapons, enhance security at our airports, seaports, land borders and local communities, and strengthen America's preparedness and response capabilities. Every level of government, the private sector, and individual citizens contribute to homeland security—the concerted national effort to prevent terrorist attacks within the United States, reduce America's vulnerability to terrorism, and minimize the damage from attacks that may occur. Since September 11th, homeland security has become a major policy focus for all levels of government, and one of the President's highest priorities.

To examine homeland security as a crosscutting Government-wide function, section 889 of the Homeland Security Act of 2002 requires a homeland security funding analysis to be incorporated in the President's Budget. This analysis addresses that legal requirement. It covers the homeland security funding and activities of all Federal agencies, not only those carried out by the Department of Homeland Security (DHS), and discusses State, local, and private sector expenditures. In addition, not all activities carried out by DHS constitute homeland security funding (e.g., Coast Guard search and rescue activities), so DHS estimates in this section do not represent the entire DHS budget.

Federal Expenditures

The Federal spending estimates in this analysis utilize funding and programmatic information collected on the Executive Branch's homeland security efforts[1]. Throughout the budget formulation process, the Office of Management and Budget (OMB) collects three-year funding estimates and associated programmatic information from all Federal agencies with homeland security responsibilities. These estimates do not include programs or funding within the Legislative or Judicial branches. Information in this chapter is augmented by a detailed appendix of account-level funding estimates, which is available on the *Analytical Perspectives* CD ROM.

To compile these data, agencies report information using standardized definitions for homeland security. The data provided by the agencies are developed at the "activity level," which is a set of like programs or projects that make up a coherent effort, at a level of detail sufficient to analyze governmental spending on homeland security. Agencies further categorize their funding data based on the critical mission areas defined in the *National Strategy for Homeland Security:* intelligence and warning, border and transportation security, domestic counterterrorism, protecting critical infrastructures and key assets, defending against catastrophic threats, and emergency preparedness and response. In all tables, classified funding for the Intelligence Community is combined with the Department of Defense and titled "Department of Defense."

To the extent possible, this analysis maintains programmatic and funding consistency with previous estimates. Some discrepancies from data reported in earlier years arise due to agencies' improved ability to extract terrorism-related activities from host programs and refine their characterizations. In addition, the Administration may refine definitions or mission area estimates over time based on additional analysis or changes in the way specific activities are characterized, aggregated, or disaggregated. Activities in many of the mission areas are closely related. For example, information gleaned from activities in the intelligence and warning category may be utilized to inform law enforcement activities in the domestic counterterrorism category. Augmentation of pharmaceutical stockpiles, categorized as emergency preparedness and response, may address agents that represent catastrophic threats.

[1] All data in the Federal expenditures section are based on the President's policy for the 2005 Budget. Additional policy and baseline data is presented in the "Additional Tables" section and on the *Analytical Perspectives* CD ROM. Data in this section may not add to totals in other Budget volumes due to rounding.

Table 3–1. HOMELAND SECURITY FUNDING BY AGENCY

(Budget authority, in millions of dollars)

Agency	2003 Enacted	2003 Supplemental	2004 Enacted	2005 Request
Department of Agriculture	299.9	110.0	326.6	651.1
Department of Commerce	111.6		131.2	150.1
Department of Defense	8,442.0		7,024.0	8,023.1
Department of Education	5.7		8.0	7.7
Department of Energy	1,246.9	161.3	1,362.5	1,496.9
Department of Health and Human Services	4,002.4	142.0	4,109.0	4,276.1
Department of Homeland Security	18,652.4	4,411.0	[1] 23,492.3	27,214.5
Department of Housing and Urban Development	1.6		1.8	1.8
Department of the Interior	47.4	7.3	67.2	49.3
Department of Justice	1,892.5	456.9	[1] 2,165.8	2,581.1
Department of Labor	69.4		52.4	68.6
Department of State	632.7	1.4	701.3	954.8
Department of Transportation	382.8		283.5	242.6
Department of the Treasury	80.0		90.4	87.1
Department of Veterans Affairs	154.3		271.3	297.0
Corps of Engineers	36.0	39.0	103.4	84.0
Environmental Protection Agency	132.9		123.3	97.4
Executive Office of the President	41.0		35.0	35.0
General Services Administration	67.1		78.9	79.5
National Aeronautics and Space Administration	205.0		191.0	207.0
National Science Foundation	284.6		327.9	343.6
Office of Personnel Management	3.0		3.0	3.0
Social Security Administration	132.0		143.4	155.0
District of Columbia	25.0		19.0	15.0
Federal Communications Commission	1.0		1.0	
Intelligence Community Management Account			1.0	72.4
National Archives and Records Administration	10.1		12.0	14.6
Nuclear Regulatory Commission	47.0		66.8	57.0
Securities and Exchange Commission	5.0		5.0	5.0
Smithsonian Institution	82.8		78.3	76.0
United States Holocaust Memorial Museum	8.0		8.0	8.0
Corporation for National and Community Service	16.3		22.8	31.6
Total, Homeland Security Budget Authority	**37,118.2**	**5,329.0**	**41,307.1**	**47,385.7**
Less Department of Defense	–8,442.0		–7,024.0	–8,023.1
Less BioShield			–885.0	–2,528.0
Non-Def. Homeland Security BA excluding BioShield	**28,676.2**	**5,329.0**	**33,398.1**	**36,834.6**
Less Fee-Funded Homeland Security Programs	–3,414.4	705.0	–3,655.1	–4,080.5
Less Mandatory Homeland Security Programs	–1,759.4		–1,948.0	–2,261.4
Net Non-Def. Disc. Homeland Security BA excluding BioShield	**23,502.4**	**6,034.0**	**27,795.0**	**30,492.7**
Obligation Limitations				
Department of Transportation Obligation Limitation	567.0		139.6	92.9

[1] 2004 Enacted does not include $91 million for Coast Guard and $16 million for FBI enacted as part of the FY 2004 Iraq supplemental.

Total funding for homeland security has grown significantly since the attacks of September 11, 2001. For 2005, the President's Budget includes $47.4 billion for homeland security activities, a $6.1 billion (15 percent) increase over the 2004 level. This is $26.8 billion, or 130 percent, over the government's funding level for 2002. Excluding mandatory and fee funding, DOD, and DHS' Project Bioshield, the 2005 Budget provides an increase of $2.7 billion (9.7 percent) over the 2004 level. A total of 32 Federal agencies include homeland security funding. Of those, five agencies—the Departments of Homeland Security (DHS), Defense (DOD), Health and Human Services (HHS), Justice (DOJ) and Energy (DOE)—account for approximately 92 percent of total Government-wide homeland security funding in 2005.

The growth in Federal homeland security funding is indicative of the robust efforts that have been initiated to secure our Nation. However, it should be recognized that fully developing the strategic capacity to protect America into the future is a complex effort. There is a wide range of potential threats and risks to the Nation. To optimize the use of limited resources and minimize the potential social costs to our free and open society, homeland security activities should be prioritized based on the highest threats and risks. Homeland security represents a partnership among the Federal Government, State and local governments, the private sector, and individual citizens.

The *National Strategy for Homeland Security* provides a framework for addressing these challenges. It guides the highest priority requirements for securing the Nation. As demonstrated below, the Federal Government has used the *National Strategy* to guide its homeland security efforts. However, the *National Strategy* is not static; it represents a dynamic effort to measure progress. In some cases, progress may be easily measured. In others, Federal agencies, along with State and local governments and the private sector, are working together to develop measurable goals. Finally, in some areas, Federal agencies and partners must work to develop a better understanding of risks and threats—the biological agents most likely to be used by a terrorist group, the highest-risk and consequence critical infrastructure targets—in order to develop benchmarks. The following table summarizes funding levels by the *National Strategy's* mission areas; more detailed analysis is provided in subsequent mission-specific sections.

Table 3–2. HOMELAND SECURITY FUNDING BY NATIONAL STRATEGY MISSION AREA

(Budget authority, in millions of dollars)

Agency	2003 Enacted	2003 Supplemental	2004 Enacted	2005 Request
Intelligence and Warning	125.1	86.0	268.7	474.1
Border and Transportation Security	15,170.8	1,859.0	15,322.5	17,074.6
Domestic Counterterrorism	2,509.2	522.6	2,994.1	3,419.8
Protecting Critical Infrastructure and Key Assets	12,893.1	388.3	12,571.0	14,060.0
Defending Against Catastrophic Threats	2,428.4	201.1	2,827.2	3,358.2
Emergency Preparedness and Response	3,873.2	2,272.0	7,132.5	8,802.4
Other	118.3	....	191.1	196.5
Total, Homeland Security Budget Authority	**37,118.2**	**5,329.0**	**41,307.1**	**47,385.7**

National Strategy Mission Area: Intelligence and Warning

The intelligence and warning mission area covers activities to detect terrorist threats and disseminate terrorist-threat information. The category includes intelligence collection, risk analysis, and threat-vulnerability integration activities for preventing terrorist attacks. It also includes information sharing activities among Federal, State, and local governments, relevant private sector entities (particularly custodians of critical infrastructure), and the public at large. It does not include most foreign intelligence collection, although this intelligence may inform homeland security activities. In 2005, the bulk of the funding for intelligence and warning is in DHS (61 percent in 2005), primarily in the Information Analysis and Infrastructure Protection (IAIP) Directorate and the Secret Service. Other large contributors are DOJ (19 percent in 2005), primarily in the Federal Bureau of Investigation (FBI), and the Intelligence Community (15 percent in 2005), for the Terrorist Threat Integration Center (TTIC).

The major requirements addressed in the intelligence and warning mission area include:

- Unifying and enhancing the Government's intelligence and analytical capabilities to ensure officials have the information they need to preempt attacks.
- Implementing the Homeland Security Advisory System to allow Federal, State, local, and private authorities to take action to prevent attacks and protect potential targets.

The Administration is addressing these homeland security requirements through a variety of efforts. Over the past year, significant steps have been taken to enhance coordination of information collection and analysis. The multi-agency TTIC, the Terrorist Screening Center (TSC), and DHS' IAIP Directorate were established. These new units are improving information sharing among agencies and reducing potential gaps

Table 3–3. INTELLIGENCE AND WARNING FUNDING

(Budget authority, in millions of dollars)

Agency	2003 Enacted	2003 Supplemental	2004 Enacted	2005 Request
Department of Agriculture	0.8	....	0.8	19.8
Department of Homeland Security	86.3	....	239.9	290.3
Department of Justice	35.7	86.0	24.5	91.1
Department of the Treasury	2.3	....	2.5	0.6
Intelligence Community Management Account	....	....	1.0	72.4
Total, Intelligence and Warning	**125.1**	**86.0**	**268.7**	**474.1**

in intelligence. They were explicitly established as "hubs" to receive and share threat information with multiple Federal agencies and other entities. A further example of intelligence coordination is the Memorandum of Agreement signed by the Secretary of Homeland Security, the Attorney General, and the Director of Central Intelligence to improve the flow of homeland security information between their agencies.

Announced by the President in the 2003 State of the Union, the multi-agency TTIC commenced operations on May 1st, 2003. TTIC's interagency staff fully integrates terrorist threat-related information and analysis, and seeks to break down information "stovepipes" that have hindered intelligence efforts in the past. TTIC is co-located with counterterrorism elements from the Central Intelligence Agency and FBI to further improve communication and analysis.

To complement the TTIC, the Administration initiated the TSC, which began operations in December 2003. The TSC was formed to consolidate Government watch lists and provide operational support for thousands of Federal screeners across the country and around the world by making this consolidated information accessible to Federal, State and local agencies. Information provided by TSC will allow Government investigators, screeners and agents to act quickly when a suspected terrorist is screened or stopped. The TSC works closely with the TTIC to ensure that the single, consolidated list of terrorist suspects is accurate and regularly updated.

Enhancing the FBI's analytical capability has been a major priority to improve the Government's overall ability to deter, detect, and prevent terrorist attacks. The FBI has created an Office of Intelligence to establish intelligence requirements and coordinate information collection and sharing. The President's Budget requests $29 million for this new office.

IAIP was established as part of DHS to fill a new and unique role: mapping threat information against our nation's vulnerabilities, and working with the Federal, State, and local government officials and private sector custodians of critical infrastructure to mitigate those vulnerabilities. Over the past year, the IAIP has made considerable strides by working with its partners within the intelligence community to become a focal point for integrating and disseminating operational and situational awareness information. For example, IAIP is partnering with homeland security directors of States and territories to establish joint regional information exchange systems using DHS' Homeland Security Operations Center. IAIP is working to not only eliminate barriers to information sharing but also create avenues to share information to its partners on specific threats, vulnerabilities, and responses to the threat.

In addition, IAIP is responsible for operating the Homeland Security Advisory System (HSAS), which communicates threat alerts to the general public and government entities. IAIP is working to refine the warning system. For 2005, the President requests $10 million for the HSAS. The Federal Government is working to link other agency warning systems to the HSAS and to other public and private sector alert networks. DHS has been leading efforts to harmonize Federal systems, such as the National Oceanic and Atmospheric Administration's all-hazards and weather radio system in the Department of Commerce, and has been working with State, local, and private sector entities to link systems, speed notification processes, and allow for more targeted warnings

National Strategy Mission Area: Border and Transportation Security

This mission area covers activities to protect border and transportation systems, such as screening airport passengers, detecting dangerous materials at ports overseas and at U.S. ports-of-entry, and patrolling our coasts and the land between ports-of-entry. The majority of funding in this mission area ($15.9 billion, or 93 percent, in 2005) is in DHS, largely for the U.S. Customs and Border Protection (CBP), the Transportation Security Administration (TSA), and the Coast Guard. Other DHS bureaus and other Departments, such as State and Agriculture, also play significant roles as well. The President's 2005 request would increase funding for border and transportation security activities by 11 percent over the 2004 level.

Securing our borders and transportation systems is a complex task. The Administration's "Smart Border" initiative targets resources toward the highest risks and threats while facilitating the legitimate flow of commerce. This is cornerstone of an effective border and transportation security strategy. The creation of DHS, which unified the Federal Government's major border and transportation security resources, facilitates the integration of risk targeting systems and ensures greater accountability in border and transportation security.

Table 3–4. BORDER AND TRANSPORTATION SECURITY FUNDING

(Budget authority, in millions of dollars)

Agency	2003 Enacted	2003 Supplemental	2004 Enacted	2005 Request
Department of Agriculture	143.2	....	163.1	169.2
Department of Homeland Security	14,169.2	1,859.0	14,403.2	15,943.4
Department of Justice	25.4	....	20.1	24.4
Department of State	591.8	....	668.9	919.0
Department of Transportation	241.3	....	67.2	18.6
Total, Border and Transportation Security	**15,170.8**	**1,859.0**	**15,322.5**	**17,074.6**

Rather than having separate systems for managing the flow of goods, people, and agricultural products, one agency is now accountable for ensuring there is one cohesive border management system.

In the area of aviation security, the Federal Government has implemented the Aviation and Transportation Security Act of 2001. While intelligence suggests that aviation remains a preferred instrument of terrorism, Federal actions have bolstered the Nation's defenses. The Federal Government funded the installation of reinforced, blast-resistant cockpit doors on all large commercial passenger aircraft. More than 7,000 screening devices have been installed in all 429 commercial airports. Screeners have been replaced or retrained at all airport checkpoints and all passengers on U.S. aircraft are pre-screened against terrorism watch lists. Aircraft and airport access controls have been tightened for all U.S. airports, and the Government is working with other nations to improve aviation security. DHS also recently implemented new air cargo security requirements so that high risk cargo may not be carried on passenger aircraft. The 2005 Budget supports substantial new investments in aviation security, including an increase of nearly $900 million increase over 2004 for TSA. This funding will help ensure strong screening system performance through more training, improved technology, and explosive detection system replacement at high volume airports. In addition, $60 million is provided to DHS to continue accelerated development of improved technologies to counter the threat of portable anti-aircraft missiles. The Budget also supports a regulatory enforcement program in CBP and TSA to ensure that the air cargo industry is complying with the higher security standards, and invests in research and development for better cargo screening technologies.

The security of our seaports is no less critical, since terrorists may seek to use them to enter the country or introduce weapons or other dangerous materials. With 95 percent of all U.S. cargo passing through the Nation's 361 ports, a terrorist attack on a seaport could be economically devastating. The Maritime Transportation Security Act (MTSA) and its implementing regulations, issued by DHS in October 2003, require certain ports, vessels, and facilities to conduct security assessments. DHS will establish security standards for certain vessels and facilities, and require them to adopt security plans based on their assessments.

The 2005 Budget provides nearly $2 billion for port security, including $1.7 billion for Coast Guard activities such as Maritime Safety and Security Teams and Sea Marshals and nearly $50 million for port security grants. This includes over $100 million in new funding for the Coast Guard to develop and approve security plans, ensure foreign vessels arriving in the U.S. are in compliance with the new international port security standards, and enhance its intelligence and surveillance capabilities.

CBP is responsible for inspecting travelers at ports of entry for immigration, customs, and agriculture compliance, as well as interdicting illegal crossers between ports of entry. DHS streamlined border operations by merging inspection forces formerly maintained by the Departments of the Treasury, Justice, and Agriculture. CBP also includes the Border Patrol, formerly maintained by the Department of Justice. The merging of the agencies responsible for ensuring that all goods and persons entering and exiting the United States do so legally has improved accountability by leveraging all of our border security assets; creating a clear chain of command; and allowing for a comprehensive, cohesive border security strategy.

To secure our borders while also maintaining openness to travel and trade, CBP utilizes a risk-based, layered security approach. Overall funding for CBP homeland security activities in 2005 would increase by almost $200 million over the 2004 enacted level, with enhancements supporting additional inspectors at ports-of-entry, additional Border Patrol agents, inspection equipment, enhancements to tracking and targeting databases, and information technology upgrades. Further, through its Container Security Initiative (CSI), CBP has addressed an area of identified risk—the security of international shipping containers. CSI aims to push our borders outward by screening cargo containers at foreign ports before the containers are placed on ships bound for the United States. The 2005 Budget provides $25 million in new funding for CSI. Another focus for CBP is new and improved inspection equipment. Nearly $300 million has been directed for this endeavor since September 11th. The new equipment affords inspectors the ability to examine a larger percentage of containers more easily than in the past. The 2005 Budget provides over $100 million to CBP for such equipment, including $50 million in funding to defend against radiological and nuclear threats by deploying next-generation radiation detection technologies. Additionally, CBP will continue deployments of current Non-Intrusive Inspection technologies to expand radiation detection capability across our borders.

Another important element of a smart border strategy is managing the pre-entry, entry, stay, and departure of visitors. To do so, the 2005 Budget requests $340 million in DHS' Border and Transportation Security Directorate to continue implementation of U.S. VISIT, an entry-exit control system to record the arrivals and departures of travelers. This program will provide specific information about who is entering the country and who is staying past their period of authorized admission.

To ensure effective detention and removal of illegal aliens present in the U.S., the 2005 Budget also supports a nearly $100-million increase for the Detention and Removal Program. This includes funding to expand the program to apprehend alien fugitives and to increase efforts to ensure that aliens convicted of crimes in the U.S. are deported directly from correctional institutions after their time is served.

National Strategy Mission Area: Domestic Counterterrorism

Funding in the domestic counterterrorism mission area covers Federal and Federally-supported efforts to identify, thwart, and prosecute terrorists in the United States. The Department of Justice (largely for the FBI) and DHS (largely for U.S. Immigration and Customs Enforcement, or ICE) are the largest contributors to the domestic counterterrorism mission, accounting for $1.9 billion (57 percent) and $1.4 billion (41 percent) in funding for 2005, respectively. The President's 2005 request would increase funding for domestic counterterrorism activities by 14 percent over the 2004 level.

Since the attacks of September 11th, preventing and interdicting terrorist activity within the United States has become a priority for law enforcement at all levels of government. The major requirements addressed in the intelligence and warning mission area include:

- Developing a proactive law enforcement capability to prevent terrorist attacks.
- Apprehending potential terrorists.
- Improving law enforcement cooperation and information sharing to enhance domestic counterterrorism efforts across all levels of government.

The FBI has transformed its focus into to one dedicated to preventing terrorist attacks. In a series of measures to support this transformation, resources have been shifted from lower priority programs; analytical capability has been enhanced; additional field investigators have been hired; and headquarters oversight and management of terrorism cases has been strengthened. Overall, FBI resources in the domestic counterterrorism category have increased from $0.9 billion in 2003 to $1.3 billion in 2005, with the 2005 Budget providing an increase of approximately $300 million over the 2004 level. This increase will support a range of activities, such as counterterorism investigations and countering cyber crime.

By merging existing immigration and customs enforcement functions into ICE, the Department of Homeland Security created one of America's most robust law enforcement agencies. The Nation is better prepared to apprehend potential terrorists because the information and resources to identify and investigate illegal activities, such as smuggling, identity theft, money laundering, and trafficking in dangerous materials are combined. The 2005 Budget provides an increase of $160 million over the 2004 level for these enforcement activities.

Cooperation among law enforcement agencies assumes its most tangible operational form in the Joint Terrorism Task Forces (JTTFs) that are currently established in 66 cities. These task forces are devised to prevent and investigate terrorism. They combine the national and international investigative resources of the FBI and other Federal agencies with the street-level expertise of local law enforcement agencies. This "cop-to-cop" cooperation has proved successful in disrupting terrorist activity. The 2005 Budget provides funding to support 18 additional JTTFs.

Table 3–5. DOMESTIC COUNTERRORISM FUNDING

(Budget authority, in millions of dollars)

Agency	2003 Enacted	2003 Supplemental	2004 Enacted	2005 Request
Department of Homeland Security	1,012.6	171.7	1,246.2	1,410.1
Department of Justice	1,455.0	350.8	1,677.7	1,938.3
Department of Transportation	1.0	....	21.0	21.0
Department of the Treasury	40.6	....	45.2	46.0
Social Security Administration	....	....	4.0	4.4
Total, Domestic Counterterrorism	**2,509.2**	**522.6**	**2,994.1**	**3,419.8**

National Strategy Mission Area: Protecting Critical Infrastructure and Key Assets

Funding in the protecting critical infrastructure and key assets mission area captures the efforts of the U.S. Government to secure the Nation's infrastructure, including information infrastructure, from terrorist attacks. Protecting the Nation's key assets is a complex challenge because more than 85 percent are not Federally-owned. DOD reports the largest share of funding in this category for 2005 ($7.6 billion, or 54 percent, in 2005), and includes programs focusing on physical security and improving the military's ability to prevent or mitigate the consequences of attacks against soldiers and bases. DHS has overall responsibility for prioritizing and executing infrastructure protection activities at a national level and accounts for $2.6 billion (18 percent) of 2005 funding. A total of 26 other agencies report funding to protect their own assets and to work with States, localities, and the private sector to reduce vulnerabilities in their areas of expertise. The President's 2005 request increases funding for activities to protect critical infrastructure and key assets by $1.5 billion (12 percent) over the 2004 level, of which $1 billion is for DOD.

Securing America's critical infrastructure and key assets is a complicated task. The major requirements include:

- Unifying disparate efforts to protect critical infrastructure across the Federal Government, and with State, local, and private stakeholders.
- Building and maintaining a complete and accurate assessment of America's critical infrastructure and key assets and prioritizing protective action based on risk.
- Enabling effective partnerships to protect critical infrastructure.
- Reducing threats and vulnerabilities in cyberspace.

The IAIP Directorate, as part of DHS, is responsible for prioritizing and addressing these requirements at a national level. One of the first tasks undertaken by IAIP involved cataloguing critical infrastructure and key assets of national-level importance. IAIP leverages tactical intelligence with a risk-based strategy that identifies critical infrastructures in the targeted areas that might be affected by a terrorist incident, works to understand the vulnerabilities of that infrastructure, and recommends protective measures. In addition, IAIP trains State and local officials to improve security in the areas surrounding up to 1,000 key infrastructures sites per year. The FY 2005 Budget provides $287 million for the broad range of IAIP's infrastructure protection activities.

Cyberspace security is a key element of infrastructure protection because the internet and other computer systems link many infrastructure sectors. The consequences of a cyber attack could cascade across the economy, imperiling public safety and national security. In response, DHS has established the National Cyber Security Division (NCSD) to identify, analyze and reduce cyber threats and vulnerabilities, coordinate incident response, and provide technical assistance. Since its formal establishment in 2003, NCSD has worked with the private sector to improve security of the Nation's information infrastructure. For example, it coordinated the response and mitigation of the Blaster worm and SoBig virus. $80 million is requested for the NCSD in 2005.

Even with the creation of IAIP, the Government continues to utilize the infrastructure protection efforts of other Federal agencies to ensure the delivery of essential goods and services and maintain public safety and security. A number of agencies rely on specialized expertise and long-standing relationships with industry to assist them.

Sector-specific agencies outside of DHS are pursuing infrastructure protection efforts. The Department of Energy is coordinating protection activities within the energy sector as any prolonged interruption of energy supply—be it electricity, natural gas, or oil products—could be devastating to the Nation. The Department of Trans-

Table 3–6. PROTECTING CRITICAL INFRASTRUCTURE AND KEY ASSETS FUNDING

(Budget authority, in millions of dollars)

Agency	2003 Enacted	2003 Supplemental	2004 Enacted	2005 Request
Department of Agriculture	60.5	....	86.5	166.0
Department of Defense	8,124.0	....	6,543.8	7,550.7
Department of Energy	1,126.0	77.3	1,254.9	1,397.7
Department of Health and Human Services	182.3	....	164.6	173.8
Department of Homeland Security	1,739.7	250.3	2,413.1	2,558.2
Department of Justice	341.8	13.0	413.4	484.0
Department of Transportation	128.0	....	180.1	189.0
National Aeronautics and Space Administration	205.0	....	191.0	207.0
National Science Foundation	257.6	....	300.9	316.6
Social Security Administration	132.0	....	139.4	150.6
Other Agencies	596.3	47.7	883.4	866.4
Total, Protecting Critical Infrastructure and Key Assets	**12,893.1**	**388.3**	**12,571.0**	**14,060.0**

portation is working with local transit agencies to test and deploy integrated intrusion detection technologies in tunnels and open track areas in cities with major transit systems. The Department of Agriculture (USDA) is protecting agricultural resources, a source of essential commodities, through research and testing programs.

To maintain public safety and security, the Environmental Protection Agency (EPA) and DHS are working with the chemical industry to enhance measures in place to ensure the safety of facilities and to prevent accidental releases. Companies representing more than 90 percent of chemical production have adopted a comprehensive security code that includes mandatory inspections. EPA has also provided grants and technical support to help drinking water systems complete vulnerability assessments. To protect Federal facilities that could be exploited by terrorists, the Army Corps of Engineers is addressing identified vulnerabilities at its highest-priority dams. To protect the Nation's nuclear weapons complex, as well as nuclear weapons and their components while in transit between facilities, the Department of Energy has revised its assumptions of threats and requirements. The 2005 Budget includes a $166-million increase to address additional security.

A major component of ensuring public safety and security is protecting Federal employees and Federally-owned, leased, or occupied buildings from terrorist attack. The largest share of funding in this area is for DOD ($7.6 billion for 2005). This includes programs focusing on physical security and improving the military's ability to prevent or mitigate the consequences of attacks against soldiers and bases.

National Strategy Mission Area: Defending Against Catastrophic Threats

The defending against catastrophic threats mission area covers activities to research, develop, and deploy technologies, systems, and medical measures to detect and counter the threat of chemical, biological, radiological, and nuclear (CBRN) weapons. The agencies with the most significant resources in this category are HHS ($1.9 billion, or 57 percent, of the 2005 total), largely for research in the National Institutes of Health, and in DHS' Directorate of Science and Technology (S&T) ($0.9 billion, or 26 percent, of the 2005 total), to help develop and field technologies to counter CBRN threats. The President's 2005 request would increase funding for activities defending against catastrophic threats by 19 percent over the 2004 level.

The major requirements addressed in this mission area include:

- Developing countermeasures, including broad spectrum vaccines, antimicrobials, and antidotes.
- Preventing terrorist use of CBRN weapons through detection systems and procedures.

A key element in addressing these requirements as a whole is developing and maintaining adequate countermeasures for a CBRN attack. This not only means stockpiling those countermeasures that are currently available, but developing new countermeasures for agents that currently have none, and next-generation countermeasures that are safer and more effective than those that presently exist. Also, unlike an attack with conventional weapons, an attack with many CBRN weapons may not be immediately apparent. Working to ensure earlier detection and characterization of an attack is another way to protect and save lives.

The Federal Government is addressing these requirements. Primarily through the National Institutes of Health, HHS has conducted a research and development to develop next-generation diagnostics, vaccines and therapeutics to identify, prevent and treat the diseases caused by biological agents of terror. The 2005 Budget continues this effort by investing $1.7 billion, an increase of $128 million over 2004 and $1.4 billion over level prior to September 11th, including funding for a new program to focus on countermeasures against the threat of radiological and nuclear weapons. These investments have yielded results. For example, in November of 2003, NIH began the first human trial of vaccine designed to prevent Ebola infection. When proven effective, this vaccine will provide a life-saving advance in countries where the disease occurs naturally, and a medical tool to discourage and counteract the use of Ebola virus as an agent of bioterrorism. DHS' Project BioShield, categorized as emergency prepared-

Table 3–7. DEFENDING CATASTROPHIC THREATS FUNDING

(Budget authority, in millions of dollars)

Agency	2003 Enacted	2003 Supplemental	2004 Enacted	2005 Request
Department of Agriculture	44.6	110.0	20.8	227.0
Department of Commerce	63.9		60.0	69.5
Department of Defense	105.0		146.8	161.3
Department of Energy		84.0		
Department of Health and Human Services	1,664.4		1,754.5	1,930.3
Department of Homeland Security	491.0		774.0	886.0
Department of Justice	23.6	7.1	27.9	41.0
National Science Foundation	27.0		27.0	27.0
Nuclear Regulatory Commission	8.9		16.2	16.1
Total, Defending Against Catastrophic Threats	**2,428.4**	**201.1**	**2,827.2**	**3,358.2**

ness and response because it will be utilized to augment pharmaceutical stockpiles, will also spur the development new biological countermeasures.

In order to decrease the gap in time between a bioterrorist attack and the implementation of Federal, State, and local response protocols, the 2005 Budget includes a $274-million biosurveillance initiative. The initiative will help to build a comprehensive detection architecture by augmenting and integrating existing surveillance in the areas of human health, food supply, agriculture, and environmental monitoring, and then integrating those elements with each other and with other terrorist-threat information in real time. Improvements to these surveillance capabilities will be supported by investing an additional $130 million for HHS' Centers for Disease Control and Prevention, an additional $15 million for HHS' Food and Drug Administration and the Department of Agriculture, and a total of $118 million for DHS S&T in 2005. The Budget also provides $11 million for the IAIP Directorate to integrate this information.

As part of the Biosurveillance Initiative, the BioWatch program in DHS' S&T Directorate will be expanded. BioWatch continuously monitors the air for biological agents that might be released by terrorists. The 2005 Budget provides an additional $47 million to expand the program by adding scores of detectors in the top high-threat cities and at high-value targets such as stadiums and transit systems. To facilitate enhancements in the system, the budget provides $31 million in new funding for DHS to develop the next-generation of biological sensors, new detection systems at critical food nodes, and a model to enable better synthesis of biological incident data when assessing the extent of an actual attack.

USDA, HHS, and DHS will also work together to improve the inputs into the biosurveillance system and protect the safety of the Nation's food and agriculture systems from terrorist attacks. This effort spans across mission area categories, including efforts to detect catastrophic agents, improve warning systems, better protect the food and agriculture sectors from these threats on a regular basis, and, when necessary, implement response protocols. The 2005 Budget includes an increase of $357 million to expand laboratory capacity, conduct research, and improve surveillance of the food and agriculture supply. This funding will support the complete renovation and modernization of the national animal disease and diagnostic facility at Ames, Iowa. In addition, $15 million from the Biosurveillance initiative is specifically dedicated to improving food and agriculture surveillance.

National Strategy Mission Area: Emergency Preparedness and Response

The Emergency Preparedness and Response mission area covers agency efforts to prepare for and minimize the damage from major incidents and disasters, particularly terrorist attacks that would endanger lives and property or disrupt government operations. The mission area encompasses a broad range of agency incident management activities, as well as grants and other assistance to States and localities for similar purposes. DHS maintains the largest share of funding in this category ($5.9 billion, or 68 percent, for 2005), mostly for preparedness grant assistance to State and local first responders and Project BioShield. HHS, the second largest contributor ($2.2 billion, or 25 percent, in 2005), also assists to States and localities to upgrade their public health capacity. A total of 18 other agencies include emergency preparedness and response funding. A number maintain specialized response assets that may be called upon in select circumstances. In the President's 2005 Budget, funding for emergency preparedness and response activities would increase by $1.7 billion (23 percent) over the 2004 level.

Major requirements addressed in the emergency preparedness and response mission area include:

- Integrating separate Federal response plans into a single all-discipline incident management plan.
- Establishing measurable goals for national preparedness and ensuring that federal funding supports these goals
- Ensuring that Federal programs to train and equip States and localities are coordinated and complementary.

Table 3–8. EMERGENCY PREPAREDNESS AND RESPONSE FUNDING

(Budget authority, in millions of dollars)

Agency	2003 Enacted	2003 Supplemental	2004 Enacted	2005 Request
Department of Energy	120.9	....	107.6	99.2
Department of Health and Human Services	2,155.7	142.0	2,189.8	2,172.0
Department of Homeland Security	1,126.0	2,130.0	4,268.0	5,965.5
Other Agencies	470.6	....	567.0	565.8
Total, Emergency Preparedness and Response	**3,873.2**	**2,272.0**	**7,132.5**	**8,802.4**
Less BioShield	....	....	–885.0	–2,528.0
Total, Emergency Preparedness and Response excluding BioShield	**3,873.2**	**2,272.0**	**6,247.5**	**6,274.4**

- Encouraging standardization and interoperability of first responder equipment, especially for communications.
- Building a national training, exercise, evaluation system.
- Creating a national incident management system.
- Preparing health care providers for catastrophic terrorism.
- Augmenting America's pharmaceutical and vaccine stockpiles.

Many of the key elements of the national emergency response system are already in place. However, we must ensure that the investments made since September 11th to enhance Federal, State and local preparedness capabilities have actually resulted in a higher level of preparedness. Key elements in doing so are identifying capability gaps, establishing national preparedness goals, and improving response and recovery efforts at all levels of government. A related challenge is ensuring that investments in State and local preparedness are focused on new response capabilities for major events, and not supplanting normal operating expenses. DHS is leading an interagency effort to better match federal resources with achieving national preparedness goals.

From 2001 through 2004, the Federal Government has allocated $13.4 billion in State and local terrorism preparedness grant funding from the Departments of Homeland Security, Health and Human Services, and Justice, increasing spending from an annual level of approximately $300 million in 2001 to $5.0 billion in the 2005 request. The funding growth has been directed to Federal assistance for State and local preparedness and response activities, including equipping and training first responders and preparing the public health infrastructure for a range of terrorist threats. The Federal Government has also taken steps to rationalize and simplify the distribution of State and local assistance. For example, DHS now maintains a website that contains information on homeland security and public safety grant opportunities offered by DHS and other agencies across the Federal Government. In addition, DHS' Project SAFECOM has established consistent technical criteria for Federally-funded communications equipment, and is developing a strategic plan to encourage progress on standardizing equipment and protocols.

In 2004, DHS will complete a National Response Plan and begin to implement a comprehensive National Incident Management System. By the end of 2004, over 500,000 first responders will have received terrorism preparedness and response training through the Departments of Justice and Homeland Security. Over 480 terrorism preparedness exercises will have been conducted, including the largest preparedness exercise in American history (TOPOFF II). The 2005 Budget continues to provide coordinated terrorism preparedness training and equipment for State and local responders across the various responder agencies. The 2005 request includes $3.6 billion for terrorism preparedness grants, training, and exercises administered by the Office for Domestic Preparedness within DHS. DHS will also administer a new, $20 million program for planning and exercises associated with medical surge capabilities. Of this amount, $5 million is for planning and $15 million is for two pilot projects to evaluate fixed and mobile medical surge facilities capabilities.

In addition, the Budget includes $2.5 billion, $1.6 billion over the 2004 level, for Project BioShield. BioShield is designed to stimulate the development of the next generation of countermeasures by allowing the Federal Government to buy critically needed vaccines and medications for biodefense as soon as experts agree they are safe and effective enough to be added to the Strategic National Stockpile. This program provides an incentive to manufacture these countermeasures. BioShield is a shared responsibility, joining the intelligence capabilities of DHS with the medical expertise of HHS.

To take full advantage of that medical expertise, the Budget proposes to transfer funding for the Stockpile to HHS. The Budget includes $400 million to maintain and augment this supply of vaccines and other countermeasures that can be made available within 12 hours in the event of a terrorist attack or other public health emergency. The Budget also includes flexible authority to increase funding to augment the supply of antibiotics to protect the public against exposure to anthrax. HHS has the lead role in preparing public health providers for catastrophic terrorism. For 2005, HHS will provide $476 million to continue improvements for hospital infrastructure and mutual aid through the Health Resources and Services Administration (HRSA), and $829 million for States through the Centers for Disease Control and Prevention (CDC) for upgrades to State and local public health capacity. This investment will bring the total assistance provided by HHS to States, local governments and health care providers since 2001 to $5.8 billion.

Non-Federal Expenditures

Since September 11th, State and local governments and the private sector have also devoted extensive resources to the task of defending against terrorist threats. Some spending represents one-time costs; other spending is likely to be ongoing. In their roles as first responders, States and localities have hired more personnel, increased overtime for police, firefighters, and other emergency personnel, purchased new security equipment, activated and upgraded emergency operations centers, and invested in security-focused training.

In the private sector, firms have devoted more resources to enhance security and ensure the continuity of operations in the event of an attack. Private sector spending has focused on strengthening information systems, reinforcing security and protection, improving surveillance, and establishing and improving backup systems and inventory management so that activities can be maintained in the event of a major disruption of normal operations.

In order to estimate expenditures for homeland security activities by State and local governments and the private sector for the prior fiscal year and the current fiscal year, a number of methodological issues need to be addressed. Unlike the Federal Government, many State and local governments and private sector firms do not have budget systems that uniformly separate homeland security spending from other spending. Even when homeland security spending is tracked at the level of individual governmental units or firms, there is no organized data collection system for aggregating spending and for estimating spending for entities that do not collect homeland security data. This leads to a number of concerns with State, local, and private sector estimates that have been developed for, or are related to, homeland security:

- Entities that have reported estimates may not have used a uniform definition of homeland security activities. For example, private firms have difficulty separating expenditures primarily motivated by the threat of terrorism from other security expenses, and State and local governments may not have separated general public safety costs from activities more clearly motivated by the threat of terrorism, such as purchases of bullet proof vests versus specialized training for incidents involving weapons of mass destruction. Furthermore, the large number of Federal, State, local, and private entities that perform homeland security activities makes it difficult to collect estimates and ensure uniformity.
- Funding estimates may not have been categorized in a uniform way. For example, it is unclear whether certain estimates have reflected amounts budgeted versus amounts expended, or that certain estimates have been normalized to conform to a uniform fiscal year.
- Expenditures for homeland security may be double-counted. For example, the ramp-up in State and local expenditures since September 11th may be attributed to the increase in Federal grant funding for homeland security activities (see discussion below). The same applies to funding transfers among States and counties or cities. Although some estimates have attempted to control for this, uniform estimates that differentiate between where funding originated versus where it is ultimately expended are not available at this time. The possibility that fiscal substitution may have occurred—that one governmental entity lowered what it planned to spend based on anticipated funds from another source—is also a problem.
- Many of the homeland security spending estimates generated since September 11th focus exclusively on increases, without accounting for pre-existing activities. A valid comparison must capture these historical costs in a logical way. For example, while public safety spending related to terrorism may have increased, it is problematic to assert that there were no homeland security activities at the State and local level before September 11th. Conversely, not all State and local and local public safety spending since that date may be attributed to homeland security. Furthermore, because some homeland security expenditures may be one-time costs or costs that occur infrequently (e.g., purchasing additional security cameras), some of the expenditures that occurred in the wake of September 11th may be one-time or infrequent costs.

Given these issues, it is not surprising that there is a wide range of plausible estimates of non-Federal homeland security spending.

Two private consulting firms have published estimates based on responses to surveys they conducted of a sample of States, localities, and private-sector firms. The estimates are shown in the table below. The wide range between the low and high estimates developed by Deloitte Consulting, and the wider range between those estimates and the estimates developed by International Horizons Unlimited attests to the difficulty of accurately estimating non-Federal homeland security spending.

The estimates by International Horizons Unlimited are on a Federal fiscal year basis. The Deloitte Consulting estimates are on a fiscal year basis appropriate to the reporting entity. For States and localities, the fiscal year most often, but not always, begins July 1; for corporations, there are several common starting dates for fiscal years, including July 1, October 1, and January 1. For State and local spending, both sets of estimates attempted, as best as possible, to remove spending that was funded by Federal grants to avoid any double counting of spending that was reported by the Federal Government. Federal grants to States and localities for homeland security activities totaled $5.2 billion in FY 2003 and are estimated to be $5.5 billion in 2004.

The Administration will work closely with other public and private entities in the coming year to improve estimates of homeland security spending for inclusion in the 2006 Budget.

Table 3–9. ESTIMATES OF NON-FEDERAL HOMELAND SECURITY EXPENDITURES

(funding estimates, in billions of dollars)

	2003	2004
States and localities		
International Horizons Unlimited	6.5	7.5
Deloitte Consulting	14.6 to 29.2	around 15
Private Sector		
International Horizons Unlimited	4.5	4.8
Deloitte Consulting	45.9 to 76.5	around 46

Sources: "The Homeland Security Market," Aviation Week/Deloitte Consulting, June 2002

Additional Tables

The tables in the Federal expenditures section above present data based on the President's policy for the 2005 Budget. The tables below present additional policy and baseline data, as directed by the Homeland Security Act of 2002.

Estimates by Agency

Table 3–10. DISCRETIONARY FEE-FUNDED HOMELAND SECURITY ACTIVITIES BY AGENCY

(Budget authority, in millions of dollars)

Agency	2003 Enacted	2003 Supplemental	2004 Enacted	2005 Request
Department of Energy	1.2	....	1.2	1.2
Department of Homeland Security	2,571.0	–705.0	2,701.0	2,875.0
Department of Labor	4.0	....	14.9	16.1
Department of State	591.8	....	649.0	898.0
General Services Administration	61.5	....	72.8	73.2
Social Security Administration	132.0	....	143.4	155.0
Federal Communications Commission	1.0	....	1.0	....
Nuclear Regulatory Commission	47.0	....	66.8	57.0
Securities and Exchange Commission	5.0	....	5.0	5.0
Total, Discretionary Homeland Security Fee-Funded Activities	**3,414.4**	**–705.0**	**3,655.1**	**4,080.5**

Table 3–11. MANDATORY HOMELAND SECURITY FUNDING BY AGENCY

(Budget authority, in millions of dollars)

Agency	2003 Enacted	2003 Supplemental	2004 Enacted	2005 Request
Department of Agriculture	119.0	....	133.0	140.0
Department of Commerce	9.5	....	9.5	10.8
Department of Energy	10.0	....	11.0	11.0
Department of Health and Human Services	13.6	....	13.7	14.6
Department of Homeland Security	1,603.6	....	1,777.6	2,082.4
Department of Labor	3.7	....	3.2	2.6
Total, Homeland Security Mandatory Programs	**1,759.4**	....	**1,948.0**	**2,261.4**

Table 3–12. BASELINE ESTIMATES—TOTAL HOMELAND SECURITY FUNDING BY AGENCY

(Budget authority, in millions of dollars)

Agency	2004 Enacted[1]	Baseline				
		2005	2006	2007	2008	2009
Department of Agriculture	326	336	315	324	334	345
Department of Commerce	131	135	141	142	149	152
Department of Defense	7,025	7,221	7,425	7,646	7,883	8,131
Department of Education	8	8	8	8	8	9
Department of Energy	1,362	1,380	1,388	1,411	1,439	1,468
Department of Health and Human Services	4,108	4,169	4,241	4,320	4,409	4,503
Department of Homeland Security[2]	23,492	25,946	23,892	24,449	25,059	27,878
Department of Housing and Urban Development	2	2	2	2	2	3
Department of the Interior	66	66	69	70	74	74
Department of Justice	2,166	2,229	2,296	2,368	2,444	2,527
Department of Labor	53	53	50	52	53	55
Department of State	702	710	722	734	748	763
Department of Transportation	285	292	302	311	320	331
Department of the Treasury	91	93	95	100	104	106
Department of Veterans Affairs	271	275	280	285	290	297
Corps of Engineers	103	104	106	108	110	112
Environmental Protection Agency	123	124	125	130	133	135
Executive Office of the President	35	35	36	37	37	38
General Services Administration	79	79	82	82	83	86
National Aeronautics and Space Administration	191	193	196	199	204	208
National Science Foundation	327	331	336	342	348	355
Office of Personnel Management	3	3	3	3	3	3
Social Security Administration	139	141	143	145	148	151
District of Columbia	19	19	19	20	21	21
Federal Communications Commission	2	2	2	2	2	2
Intelligence Community Management Account	1	1	1	1	1	1
National Archives and Records Administration	12	12	12	13	13	13
Nuclear Regulatory Commission	67	69	71	74	75	78
Securities and Exchange Commission	5	5	5	5	5	5
Smithsonian Institution	78	81	85	89	91	96
United States Holocaust Memorial Museum	8	8	8	8	8	9
Corporation for National and Community Service	23	23	23	24	25	25
Total, Homeland Security Budget Authority	**41,307**	**44,145**	**42,479**	**43,504**	**44,623**	**47,980**
Less Department of Defense	–7,025	–7,221	–7,425	–7,646	–7,883	–8,131
Less BioShield	–885	–2,528	....	....	....	–2,175
Non-Def. Homeland Security BA excluding BioShield	**33,398**	**34,396**	**35,054**	**35,858**	**36,740**	**37,674**
Less Fee-Funded Homeland Security Programs	–3,651	–3,688	–3,744	–3,810	–3,885	–3,963
Less Mandatory Homeland Security Programs	–1,948	–2,262	–2,204	–2,222	–2,243	–2,264
Net Non-Def. Disc. Homeland Security BA excluding BioShield	**27,795**	**28,446**	**29,106**	**29,826**	**30,612**	**31,447**
Obligations Limitations						
Department of Transportation Obligations Limitation	133	135	137	139	143	145

[1] Details may not add to totals due to rounding differences.

[2] DHS baseline estimates include BioShield funding in 2004 ($885M), 2005 ($2,528M), and 2009 ($2,175M).

Estimates by Budget Function

Table 3–13. HOMELAND SECURITY FUNDING BY BUDGET FUNCTION

(budget authority, in millions of dollars)

	2003 Enacted [1]	2004 Enacted	2005 Request
National Defense	10,461	9,098	10,368
International Affairs	634	702	955
General Science Space and Technology	533	555	608
Energy	91	109	99
Natural Resources and the Environment	274	319	258
Agriculture	402	313	614
Commerce and Housing Credit	106	110	126
Transportation	9,481	7,997	9,206
Community and Regional Development	3,601	2,974	3,147
Education, Training, Employment and Social Services	166	151	174
Health	4,231	5,082	6,864
Medicare	10	13	14
Income Security	7	6	7
Social Security	132	143	155
Veterans Benefits and Services	154	271	297
Administration of Justice	11,543	12,829	13,800
General Government	623	634	690
Total, Homeland Security Budget Authority	**42,447**	**41,307**	**47,386**
Less DoD (National Defense)	–8,442	–7,025	–8,022
Less BioShield	....	–885	–2,528
Total non-Defense Homeland Security BA excluding BioShield	**34,005**	**33,398**	**36,836**
Less Fee-Funded Homeland Security Programs	–2,709	–3,655	–4,080
Less Mandatory Homeland Security Programs	–1,760	–1,948	–2,262
Net Non-Defense Disc. Homeland Security BA excluding BioShield	**29,536**	**27,795**	**30,493**

[1] FY 2003 Enacted includes supplemental funding; details may not add to totals due to rounding differences.

Table 3–14. BASELINE ESTIMATES—HOMELAND SECURITY FUNDING BY BUDGET FUNCTION

(Budget authority, in millions of dollars)

Budget Authority	**2004 Enacted [1]**	Baseline				
		2005	**2006**	**2007**	**2008**	**2009**
National Defense	9,098	9,321	9,556	9,812	10,091	10,385
International Affairs	702	710	722	734	748	763
General Science Space and Technology	555	562	570	580	591	603
Energy	109	111	103	106	108	111
Natural Resources and the Environment	319	321	328	336	346	351
Agriculture	313	323	302	310	320	331
Commerce and Housing Credit	111	115	120	121	127	129
Transportation	7,997	8,440	8,604	8,798	9,009	9,236
Community and Regional Development	2,974	3,013	3,060	3,111	3,171	3,235
Education, Training, Employment and Social Services	151	154	158	165	169	177
Health [2]	5,082	6,788	4,332	4,414	4,504	6,775
Medicare	13	13	14	14	15	15
Income Security	6	6	3	3	3	4
Social Security	139	141	143	145	148	151
Veterans Benefits and Services	271	275	280	285	290	297
Administration of Justice	12,829	13,211	13,532	13,906	14,305	14,724
General Government	634	641	652	664	678	693
Total, Homeland Security Budget Authority	**41,307**	**44,145**	**42,479**	**43,504**	**44,623**	**47,980**
Less DoD (National Defense)	–7,025	–7,221	–7,425	–7,646	–7,883	–8,131
Less BioShield	–885	–2,528	....	....	....	–2,175
Total non-Defense Homeland Security BA, excluding BioShield	**33,398**	**34,396**	**35,054**	**35,858**	**36,740**	**37,674**
Less Fee-Funded Homeland Security Programs	–3,651	–3,688	–3,744	–3,810	–3,885	–3,963
Less Mandatory Homeland Security Programs	–1,948	–2,262	–2,204	–2,222	–2,243	–2,264
Net non-Def. Disc. Homeland Security BA excluding BioShield	**27,795**	**28,446**	**29,106**	**29,826**	**30,612**	**31,447**

[1] Details may not add to totals due to rounding differences.

[2] Health function baseline estimates include BioShield funding in 2004 ($885M), 2005 ($2,528M), and 2009 ($2,175M).

Detailed Estimates by Budget Account

An appendix of account-level funding estimates, organized by *National Strategy* mission area, is available on the *Analytical Perspectives* CD ROM.

4. STRENGTHENING FEDERAL STATISTICS

Federal statistical programs produce key information about a range of topics of interest to public and private decision makers, including the economy, the population, agriculture, crime, education, energy, the environment, health, science, and transportation. The ability of governments, businesses, and citizens to make appropriate decisions about budgets, employment, investments, taxes, and a host of other important matters depends critically on the ready availability of relevant, accurate, and timely Federal statistics.

Moreover, for Federal statistical programs to meet the needs of a wide range of users, the underlying data systems must be viewed as credible. In order to foster this credibility, Federal statistical programs seek to adhere to high quality standards and to maintain integrity and efficiency in the production of statistics. As the collectors and providers of these basic data, Federal agencies act as data stewards—balancing public and private decision makers' needs for information with legal and ethical obligations to minimize reporting burden, respect respondents' privacy, and protect the confidentiality of the data provided to the Government. This chapter discusses the development of standards that principal statistical programs can use to assess their performance and presents highlights of their 2005 budget proposals.

Performance Standards

Agencies maintain the quality of their data or information products as well as their credibility by setting high performance standards for their activities. The statistical agencies and statistical units represented on the Interagency Council on Statistical Policy (ICSP) have collaborated on developing an initial set of common performance standards for use under the Government Performance and Results Act and in completing the Administration's new Program Assessment Rating Tool (PART). Federal statistical agencies have agreed that there are six conceptual dimensions within two general areas of focus that are key to measuring and monitoring statistical programs. The first area of focus is Product Quality, encompassing the traditional dimensions of relevance, accuracy, and timeliness. The second area of focus is Program Performance, encompassing the dimensions of cost, dissemination, and mission achievement.

Statistical agencies historically have focused on measuring performance in the area of product quality, especially the dimensions most amenable to quantitative measurement, specifically accuracy and timeliness. Relevance, also an accepted measure of quality, can be either a qualitative description of the usefulness of products or a quantitative measure such as a customer satisfaction score. Relevance is more difficult to measure, and the indicators that do exist are more varied.

Program performance standards form the basis for evaluating effectiveness. They address questions such as: Are taxpayer dollars spent most effectively? Are products made available to those who need them? Are agencies meeting their mission requirements or making it possible for other agencies to meet their missions? The indicators available to measure program performance for statistical activities currently are less well developed than those for product quality.

Product quality and program performance standards are designed to serve as indicators when answering specific questions in the Administration's PART process. (Please refer to Chapter 2 of this volume for a description of the PART.) Figure 4–1 presents each principal Federal statistical agency's assessment of the status of its current and planned use of indicators on the six dimensions. Use of the indicators may be for internal management, strategic planning, or annual performance reporting. The dimensions shown in the figure reflect an overall set of indicators for statistical activities but the specific measures vary among the individual programs depending on their unique characteristics and requirements. Annual performance reports and PARTs contain these specific measures as well as additional information about performance goals and targets and whether a program is meeting, or making measurable progress toward meeting, its performance goals. The examples below illustrate different ways agencies track their performance on each dimension.

Product Quality: Statistical agencies agree that product quality encompasses many attributes, including (but not limited to) relevance, accuracy, and timeliness. The basic measures in this group relate to the quality of specific products, thereby providing actionable information to managers. These are "outcome-oriented" measures and are key to the usability of information products. Statistical agencies or units establish targets and monitor how well targets are met. In some sense, relevance relates to "doing the right things," while accuracy and timeliness relate to "doing things right."

> *Relevance:* Qualitative or quantitative descriptions of the degree to which products are useful and responsive to users' needs. Relevance of data products and analytic reports may be assessed through a professional review process and ongoing contacts with data users. Product relevance may be indicated by customer satisfaction with product content, information from customers about product use, demonstration of product improvements, comparability with other data series, agency responses to customer suggestions for improvement, new or

customized products/services, frequency of use, or responses to data requests from users (including policy makers). Through a variety of professional review activities, agencies maintain the relevance, accuracy, and validity of programs, and encourage data users and other stakeholders to contribute to the agency's data collection and dissemination program. Striving for relevance requires monitoring to ensure that information systems anticipate change and evolve to appropriately measure our dynamic society and economy.

Accuracy: Qualitative or quantitative measures of important features of correctness, validity, and reliability of data and information products measured as degree of closeness to target values. For statistical data, accuracy measures include sampling error and various aspects of nonsampling error (e.g., response rates, size of revisions, coverage, edit performance). For analysis products, accuracy may be the quality of the reasoning, reasonableness of assumptions, and clarity of the exposition, typically measured and monitored through review processes. In addition, accuracy is assessed and improved by external and internal reviews, comparisons of data among different surveys, linkages of survey data to administrative records, redesigns of surveys, or expansions of sample sizes.

Timeliness: Qualitative or quantitative measure of the timing of information releases. May be measured as time from the collection of data or the close of the reference period to the release of information, or customer satisfaction with timeliness. May also be measured as how well agencies meet scheduled and publicized release dates, expressed as a percent of release dates met.

Program Performance: Statistical agencies agree that program performance encompasses balancing the dimensions of cost, dissemination, and mission accomplishment for the agency as a whole; operating efficiently and effectively; ensuring that customers receive the information they need; and serving the information needs of the Nation. Costs of products or programs may be used to develop efficiency measures. Dissemination involves making sure customers receive the information they need via the most appropriate mechanisms. Mission achievement means that the information program makes a difference. Hence, three key dimensions are being used to indicate program performance: cost (input), dissemination (output), and mission achievement (outcome).

Cost: Quantitative measure of the dollar amount used to produce data products and services. The development and use of financial performance measures within the Federal Government is an established goal, and the intent of such measures is to determine the "true costs" of various programs or alternative modes of operation at the Federal level. Examples of cost data include full costs of products or programs, return on investment, dollar value of efficiencies, and ratios of cost to products distributed.

Dissemination: Qualitative or quantitative information on the availability, accessibility, and distribution of products and services. Most agencies have goals to improve product accessibility, particularly through the Internet. Typical measures include: on-demand requests fulfilled, product downloads, degree of accessibility, customer satisfaction with ease of use, number of participants at user conferences, citations of agency data in the media, number of Internet user sessions, number of formats in which data are available, amount of technical support provided to data users, exhibits to inform the public about information products, issuance of newsletters describing products, usability testing of websites, and assessing compliance with Section 508 of the Rehabilitation Act which requires Federal agencies to make their electronic and information technology accessible to people with disabilities.

Mission Achievement: Qualitative or quantitative information about the impact of or satisfaction with statistical programs. For Federal statistical programs, this dimension responds to the question—have we achieved our objectives and met the expectations of our stakeholders? Under this dimension, statistical programs document their contributions to the goals and missions of parent departments and other agencies, the Administration, the Congress, and information users in the private sector. For statistical programs, this broad dimension involves meeting recognized societal information needs and also addresses the linkage between statistical outputs and programmatic outcomes.

However, identifying this linkage is far from straightforward. It is sometimes difficult to trace the impact of information products on the public good. Such products often are necessary intermediate inputs in the creation of a high visibility product whose societal benefit is clearly recognized. For example, the economic statistics produced by a variety of agencies are directly used by the Bureau of Economic Analysis in the calculation of the Gross Domestic Product (GDP), which analysts use to assess changes in the level of domestic economic activity. Similarly, statistics from specific surveys are directly used by the Bureau of Labor Statistics in the calculation of the Consumer Price Index (CPI), which is widely used in diverse applications, such as indexing pensions for retirees. As a result, a number of statistical agencies contribute to the GDP and/or the CPI and to the many uses of these information products. In addition, the data produced by statistical agencies are used to track the performance of programs managed by their parent agencies or other organizations in areas such as crime, education, energy, the environment, health, science, and transportation.

Moreover, beyond the direct and focused uses of statistical products and programs, the statistical agencies and their products serve a diverse and dispersed set of data users working on a broad range of applications. Users include senior government policy makers at the Federal, State, and local levels, business leaders, households, academic researchers, analysts at public policy institutes and trade groups, marketers and planners in the private sector, and many others. Information produced by statistical agencies often is combined with other information for use in the decision-making process. Thus, as with many nonstatistical programs, the relationship between statistical program outputs and their beneficial uses and outcomes is often complex and difficult to track.

In the absence of preferred quantitative indicators, qualitative narratives can indicate how statistical agency products contribute to and evaluate progress toward important goals established for government or private programs. In particular, narratives can highlight how statistical agencies measure the Nation's social and economic structure, and how the availability of the information influences changes in policies and programs. These narratives contribute to demonstrating mission accomplishment, particularly in response to questions in Section I of the PART, "program purpose and design." Narratives may describe the impact of measuring agency policy or change of policy, supporting research focused on policy issues, furnishing information to inform debate on policy issues, or providing in-house consulting support.

In addition to narratives, quantitative measures may be used to reflect mission achievement. For example, customer satisfaction with the statistical agency or unit indicates if the agency or unit has met the expectations of its stakeholders.

Figure 4-1. Availability of Indicators Reported by Principal Statistical Agencies, 2005

Dimension	BEA	BJS	BLS	BTS	Census	EIA	ERS	NASS	NCES	NCHS	ORES	SOI	SRS
Product Quality													
Relevance	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Accuracy	✓	✓	✓	P	✓	✓	✓	✓	✓	✓	✓	✓	✓
Timeliness	✓	✓	✓	P	✓	✓	✓	✓	P	✓	✓	✓	✓
Program Performance													
Cost	✓	✓	✓	P	✓	—	P	P	P	P	✓	✓	—
Dissemination	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	P
Mission Achievement	✓	✓	✓	P	✓	✓	✓	✓	P	✓	✓	✓	✓

✓ Indicator Available | P Indicator in development | - No Indicator

Description of Dimensions

Product Quality

Relevance: Qualitative or quantitative description of the degree to which products and services are useful to users and responsive to their needs.

Accuracy: Qualitative or quantitative measure of important features of correctness, validity, and reliability of data and information products measured as degree of closeness to target values.

Timeliness: Qualitative or quantitative measure of the timing of information releases.

Description of Dimensions—Continued

Program Performance

Cost: Quantitative measure of the dollar amount used to produce data products and services.

Dissemination: Qualitative or quantitative information on the availability, accessibility, and distribution of products and services.

Mission Achievement: Qualitative or quantitative information about the impact of, or satisfaction with, statistical programs.

Key to Statistical Agencies

BEA = Bureau of Economic Analysis, Department of Commerce
BJS = Bureau of Justice Statistics, Department of Justice
BLS = Bureau of Labor Statistics, Department of Labor
BTS = Bureau of Transportation Statistics, Department of Transportation
Census = Census Bureau, Department of Commerce
EIA = Energy Information Administration, Department of Energy
ERS = Economic Research Service, Department of Agriculture
NASS = National Agricultural Statistics Service, Department of Agriculture
NCES = National Center for Education Statistics, Department of Education
NCHS = National Center for Health Statistics, Department of Health and Human Services
ORES = Office of Research, Evaluation, and Statistics, Social Security Administration
SOI = Statistics of Income, Internal Revenue Service, Department of the Treasury
SRS = Division of Science Resources Statistics, National Science Foundation

Of the 14 principal Federal statistical agencies that are members of the ICSP, four agencies have programs that have been assessed using the PART process. These agencies' programs have received PART summary ratings of Effective or Moderately Effective, as shown in Figure 4–2. As additional ICSP agencies have an opportunity to undergo the PART process, the agencies plan to use the results of the collaborative performance standards development effort to help maintain and extend their generally well-received assessments.

Figure 4–2. 2005 PART SUMMARY RATINGS FOR STATISTICAL PROGRAMS

	Summary Rating
Bureau of Economic Analysis	Effective
Bureau of Labor Statistics	Effective
Census Bureau	
Current Demographic Statistics	Moderately Effective
Decennial Census	Moderately Effective
Intercensal Demographic Estimates	Moderately Effective
Survey Sample Redesign	Effective
National Center for Education Statistics	
Statistics	Effective
Assessment	Effective

Highlights of 2005 Program Budget Proposals

The programs that provide essential statistical information for use by governments, businesses, researchers, and the public are carried out by some 70 agencies spread across every department and several independent agencies. Approximately 40 percent of the funding for these programs provides resources for twelve agencies or agency units that have statistical activities as their principal mission. (Please see Table 4–1.) The remaining funding supports work in 60-plus agencies that carry out statistical activities in conjunction with other missions such as providing services or enforcing regulations. More comprehensive budget and program information about the Federal statistical system will be available in OMB's annual report, *Statistical Programs of the United States Government, Fiscal Year 2005*, when it is published later this year. The following highlights elaborate on the Administration's proposals to strengthen the programs of the principal Federal statistical agencies.

Bureau of Economic Analysis: Funding is requested to complete work begun in 2003 to: (1) accelerate the release of some of the Nation's most important economic statistics to dramatically increase their usefulness to policy makers, business leaders, and other users; (2) meet U.S. statistical obligations to international organizations on the Special Data Dissemination Standards and complete the incorporation of the North American Industry Classification System into BEA accounts; (3) improve the economic accounts by acquiring monthly real-time data from private sources to fill data gaps in current measures as well as conduct a quarterly survey of large and volatile international services such as telecommunications, finance, and insurance; and (4) produce more current business investment data that include associated employment and compensation estimates on an annual basis in order to provide data needed to conduct analyses of tax policy, business investment, and productivity in manufacturing and service industries.

Bureau of Justice Statistics: Funding is requested to continue conversion of the National Crime Victimization Survey from primarily a paper and pencil operation to a fully automated data collection process. The BJS base program increase will provide for the maintenance of BJS's core statistical programs, including: (1) the National Crime Victimization Survey, the Nation's primary source of information on criminal victimization; (2) cybercrime statistics on the incidence, magnitude, and consequences of electronic and computer crime to households and businesses; (3) law enforcement data from over 3,000 agencies on the organization and administration of police and sheriffs' departments; (4) nationally representative prosecution data on resources, policies, and practices of local prosecutors; (5) court and sentencing statistics, including Federal and State case processing data; and (6) data on correctional populations and facilities from Federal, State, and local governments.

Bureau of Labor Statistics: Funding is requested to support current program operations to measure the economy through producing, disseminating, and improving BLS economic measures, including: (1) modernizing the computing systems for monthly processing of the Producer Price Index (PPI) and U.S. Import and Export Price Indexes, and producing new data outputs, such as experimental PPI's for goods and services that will provide the first economy-wide measures of changes in producer prices; (2) maintaining continuous updating of the Consumer Price Index (CPI) by updating the expenditure and population weights biennially, the superlative index annually, outlet samples on a four-year cycle, and item samples in key categories on a two-year cycle, in lieu of performing major revisions about every ten years; and (3) continuing with a multi-year effort to enhance core BLS information technology infrastructure through a central Department of Labor appropriation.

Bureau of Transportation Statistics: Funding is requested to: (1) develop the American Freight Data Program, a continuous source of freight data from shippers, carriers, and receivers, to replace the current five-year Commodity Flow Survey; (2) move the Airfare Price Index, an input to GDP and CPI indices, from experimental to production mode; and (3) develop more timely and comprehensive local and long-distance travel data.

Census Bureau: Funding is requested for the Census Bureau's economic and demographic programs and for a re-engineered 2010 Census. For the Census Bureau's economic and demographic programs, funding is requested to: (1) support the release of all remaining data products from the 2002 Economic Census; (2) begin planning for the 2007 Economic Census and Census of Governments; (3) continue efforts begun in 2003 to eliminate data gaps by measuring migration across U.S. borders; (4) improve measurement of services by expanding key source data for critical quarterly and annual estimates of our Nation's Gross Domestic Product; (5) continue efforts to offer electronic reporting for almost 100 current economic surveys; and (6) support the Automated Export System and accelerate release of trade statistics. For 2010 Census planning, funding is requested to continue to: (1) conduct extensive planning, testing, and development activities to support a re-engineered 2010 Census; (2) complete map feature accuracy within 7.6 meters of true GPS location for 48 percent of all counties in the U.S., Puerto Rico, and island areas; and (3) conduct the first full year of the American Community Survey program to provide data on an ongoing basis rather than waiting for once-a-decade censuses.

Economic Research Service: Funding is requested to develop an integrated and comprehensive data and analysis framework of the food system beyond the farm-gate to provide a basis for understanding, monitoring, tracking, and identifying changes in food supply and consumption patterns.

Energy Information Administration: Funding is requested to: (1) continue the improvement of natural gas and electricity survey data; (2) undertake development work on a liquefied natural gas storage survey and a natural gas production survey; (3) enhance the National Energy Modeling System's transportation modeling; and (4) revise the Voluntary Greenhouse Gases survey to support the President's Initiative on Greenhouse Gases.

National Agricultural Statistics Service: Funding is requested to: (1) continue restoration and modernization of the agricultural estimates program to ensure State, regional, and national level agricultural estimates of sufficient precision, quality, and detail to meet the needs of a broad customer base; and (2) support Government-wide and departmental E-Government initiatives.

National Center for Education Statistics: Funding is requested to: (1) support the second wave of data collection of the Early Childhood Longitudinal Study—Birth Cohort and data release in Spring 2005; (2) continue efforts to improve electronic data collection and data dissemination; (3) support the ongoing data collection efforts for the Schools and Staffing Survey, the principal collection on national and State level indicators of teacher and school quality; (4) continue U.S. participation in data collections, analyses, and reporting on international assessments that compare educational performance and progress across countries; and (5) continue support for the National Assessment of Educational Progress (NAEP) program and its role in benchmarking national and State performance.

National Center for Health Statistics: Funding is requested to: (1) maintain and transform HHS' core health statistics capacity; (2) preserve and modernize the Nation's vital statistics system; (3) fortify and transform basic operations for the National Health and Nutrition Examination Survey; (4) maintain and redesign systems for tracking the health care delivery system; and (5) redesign the sample for the National Health Interview Survey.

Science Resources Statistics Division, NSF: Funding is requested to: (1) implement ongoing programs on the science and engineering (S&E) enterprise; (2)

continue implementing quality improvements to surveys on the S&E workforce; (3) begin research on methods to implement necessary enhancements to the Industry Research and Development survey; (4) develop an ongoing data collection program on research instrumentation stocks, as mandated by Congress; and (5) continue activities to establish an ongoing data series on postdoctorates.

Statistics of Income Division, IRS: Funding is requested to: (1) maintain and modernize core data collection systems, including several major statistical programs for the Treasury Department, the Congressional Joint Committee on Taxation, the Bureau of Economic Analysis, and SOI's many other customers; (2) implement a databank repository for SOI and IRS population file data to more efficiently build longitudinal databases and enable sub-national estimates; (3) examine means to more effectively mask individual records to minimize the possibility of identification in the Individual Public Use sample files; and (4) modernize and expedite dissemination of data and publications, including a reengineered Internet website.

Table 4–1. 2003–2005 BUDGET AUTHORITY FOR PRINCIPAL STATISTICAL AGENCIES

(in millions of dollars)

	2003 Actual	Estimate	
		2004	2005
Bureau of Economic Analysis	66	67	82
Bureau of Justice Statistics	32	32	39
Bureau of Labor Statistics	492	518	534
Bureau of Transportation Statistics	30	31	34
Census Bureau [1]	571	632	848
Salaries and Expenses [1]	202	213	240
Periodic Censuses and Programs	369	419	608
Economic Research Service	69	71	80
Energy Information Administration	80	81	85
National Agricultural Statistics Service [2]	138	128	138
National Center for Education Statistics	184	187	187
Statistics	89	92	92
Assessment	95	95	95
National Center for Health Statistics	126	128	150
PHS Evaluation Funds	126	128	150
Budget Authority	0	0	0
Science Resources Statistics Division, NSF	31	32	32
Statistics of Income Division, IRS	32	36	36

[1] Includes mandatory appropriations of $20 million for each year for the Survey of Program Dynamics and collection of data related to the allocation to States of State Children's Health Insurance Program funds.

[2] Includes funds for the periodic Census of Agriculture of $41, $25, and $23 million in 2003, 2004, and 2005, respectively.

5. RESEARCH AND DEVELOPMENT

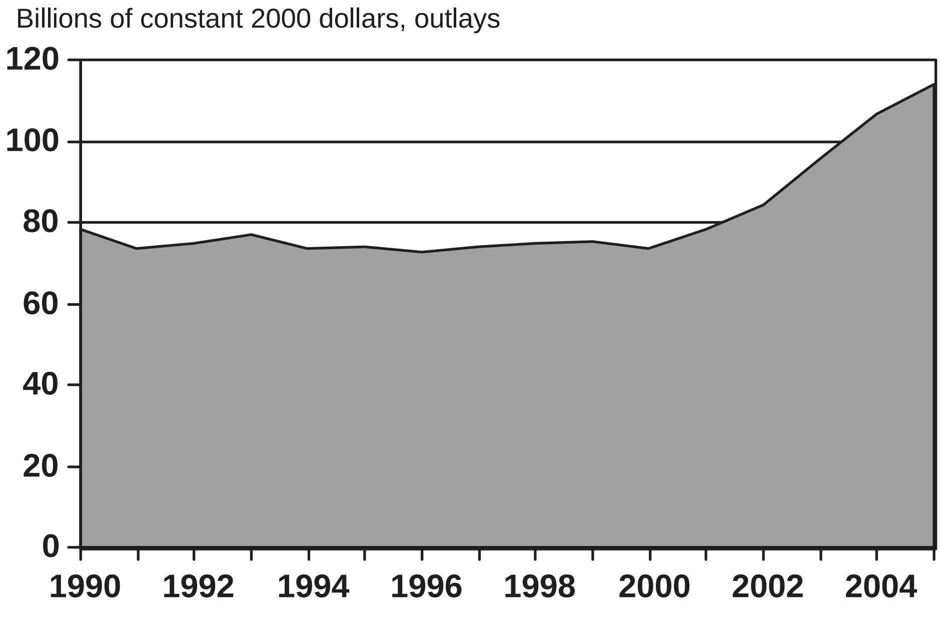
I. INTRODUCTION

The eminent 19th Century American scientist Joseph Henry once asserted, "Modern civilization depends on science." This still holds true. Indeed, investments in science and technology have resulted in much of the unparalleled economic growth in the United States over the last 50 years, as well as the standard of living and quality of life we now enjoy. Advances have been possible only with the support of both public and private investment in research and development (R&D).

And we continue to invest. The R&D investments of the United States are unmatched. However, unlike 40 years ago, when Federal R&D expenditures doubled those of the private sector, industry R&D spending now exceeds that of the Federal Government. Still, by a wide margin, the U.S. Government continues to lead the world in R&D spending.

Investments in technological advancement are vital to strengthening our capabilities to combat terrorism and defend our country. The President's 2005 Budget continues to focus R&D on winning the war against terrorism, while moderating the growth in overall spending. But the benefits of innovation and discovery are not limited to national security. They are just as critical to economic security. The Administration, recognizing that fundamental research is the fuel for future innovation and technology development, has maintained the highest levels of support for priority R&D areas such as nanotechnology, information technology, hydrogen energy, and space exploration. The non-defense R&D share of the discretionary budget is at a near-record high over the last 30 years.

Chart 5-1. Federal R&D Spending



Author Aubrey Eben noted, "Science is not a sacred cow. Science is a horse. Don't worship it. Feed it." To this we would add: the horse also needs to be kept in good shape. The focus should not be solely on spending but, just as importantly, on performance. The Administration will continue to meet the President's charge to improve the management, performance, and results of the Federal Government. By strengthening effective programs and addressing lower performers through reforms or reallocations to higher performers, we will increase the productivity of the Federal R&D portfolio and transcend the attention given to year-to-year marginal increases or decreases. Additionally, while it can be difficult to assess the outcomes of some research programs—many of which may not have a measurable effect for decades—agencies can establish meaningful program goals and measure annual progress and performance in appropriate ways. Towards that end, the Administration is continuing to implement and improve investment criteria for R&D programs across the government. Further, the government will coordinate interrelated and complementary R&D efforts among agencies, combining programs where appropriate to improve effectiveness and eliminate redundancy, to leverage these resources to the greatest effect.

The Federal Government funds R&D in many ways. The government is a strong supporter of basic research, which is directed toward greater understanding of fundamental phenomena. Basic research is the source of tomorrow's discoveries and new capabilities, and this long-term research will fuel further gains in economic productivity, quality of life, and homeland and national security. The government also has a vital role in supporting applied research, which is driven by more specific needs, and development, which applies scientific knowledge and technology to specific needs. Together, the R&D portfolio is critical to the missions of Federal agencies, particularly in priority areas that private sources are not motivated to support. For example, if the private sector cannot profit from the development of a particular technology, Federal funding may be appropriate if the technology in question addresses a national priority or otherwise provides significant societal benefits. A good indicator of the relevance of Federal development funding is the level at which industry is willing to share the costs. Also, the Federal Government should help stimulate private investment and provide the proper incentives for private sources to continue to fuel the discovery and innovation of tomorrow. The Administration proposes to do this, for instance, by permanently extending the Research and Experimentation tax credit.

This chapter discusses how the Administration will improve the performance of R&D programs through new investment principles and other means that encourage and reinforce quality research. The chapter also highlights the priority areas proposed for R&D agencies and the coordinated efforts among them. The chapter concludes with details of R&D funding across the Federal Government.

II. IMPROVING PERFORMANCE OF R&D PROGRAMS

R&D is critically important for keeping our Nation economically competitive, and it will help solve the challenges we face in health, defense, energy, and the environment. As a result, and consistent with the Government Performance and Results Act, every Federal R&D dollar must be invested as effectively as possible.

R&D Investment Criteria

The Administration is improving the effectiveness of the Federal Government's investments in R&D by continuing to apply transparent investment criteria in making recommendations for program funding and management. R&D performance assessment requires special consideration. Research often leads scientists and engineers down unpredictable pathways with unpredictable results. This poses a difficult problem for measuring an R&D program's performance against its initial goals. Adopting ideas first laid out by the National Academy of Sciences, the Administration is improving methods for setting priorities based on expected results, including applying specific criteria that programs or projects must meet to be started or continued, clear milestones for gauging progress, and improved metrics for assessing results.

As directed by the President's Management Agenda, the R&D Investment Criteria were first applied in 2001 to selected applied R&D programs at the Department of Energy (DOE). Through the lessons learned from that DOE pilot, the criteria subsequently were broadened in scope to cover other types of R&D programs at DOE and other agencies. To accommodate the wide range of R&D activities from basic research to development and demonstration programs, a new framework was devised for the criteria to address three fundamental aspects of R&D:

- *Relevance.*—Programs must be able to articulate why they are important, relevant, and appropriate for Federal investment;
- *Quality.*—Programs must justify how funds will be allocated to ensure quality; and
- *Performance.*—Programs must be able to monitor and document how well the investments are performing.

In addition, R&D projects and programs relevant to industry are expected to meet criteria to determine the appropriateness of the public investment, enable comparisons of proposed and demonstrated benefits, and provide meaningful decision points for completing or transitioning the activity to the private sector.

Year Three in DOE Implementation of the Criteria. The Department of Energy continues to expand its use of the R&D criteria. For example, to ensure the relevance of the research it supports, DOE's basic research programs have incorporated the programs' long-term measures into requests for research proposals. The basic research programs have also expanded their use of Committees of Visitors, teams of independent experts that periodically assess the quality and performance of the research that the program has supported. Many of DOE's applied R&D programs have made similar improvements, and some have even incorporated the specific "industry-related" R&D criteria into evaluation forms used by peer reviewers to assess individual projects. While DOE's applied R&D programs still are faced with the challenge of generating comparable estimates of expected public benefits, they continue to work toward improving the consistency and quality of the data to better inform budget decisions.

The Administration has been studying R&D management strategies that some agencies use to operate particularly effective programs. The Office of Management and Budget (OMB) and the Office of Science and Technology Policy (OSTP) are continuing to assess the strengths and weaknesses of R&D programs across agencies, in order to identify and apply good R&D management practices throughout the government. For example, some agencies have a more deliberate project-prioritization process, while other agencies have more experience estimating the returns of R&D and assessing the impact of prior investments. Assessing and implementing new approaches is an iterative process, involving the research agencies and the science and technology community.

As the investment criteria are implemented more broadly and more deeply, one lesson that is increasingly apparent is the importance of coordination and partnerships. First, partnerships are key in determining the proper Federal role. These include partnerships with industry (such as the Administration's FreedomCAR partnerships with U.S. automakers), partnerships with other countries (such as the Administration's International Partnership for a Hydrogen Economy), and partnerships with university researchers. Partnerships and coordination across agencies, through the National Science and Technology Council, for example, can also make the use of research resources more efficient and effective. More effective coordination and partnerships will be pursued in further implementation of the investment criteria.

Broader Application of the R&D Investment Criteria. This was the second year of implementation of the investment criteria for most R&D agencies. The National Aeronautics and Space Administration is recasting its strategic plans and budget to tie directly to the R&D criteria. To reflect the criteria, the National Science Foundation changed the way it characterizes its budget, as well as the guidelines it uses to evaluate its research. Nearly all R&D agencies assessed some R&D programs using a tailored Program Assessment Rating Tool that was based on the R&D criteria. The R&D agencies have more work to do to integrate the R&D criteria more meaningfully into their management processes and budget decisions, and OMB will continue to improve guidance and standards for implementing the R&D Investment Criteria.

DOE has started to use the results of the R&D investment criteria to help analyze its portfolio of investments on the basis of the potential public benefits. This approach helps DOE to analyze, for example, whether the expected fruits of its investments are balanced across time, as well as the types of benefits they may yield. As data analysis of the Department's applied R&D programs has shown, there is a greater need for consistent methods of analysis, including ways to present benefits estimates that make comparisons meaningful. DOE is continuing to improve the consistency and quality of its data.

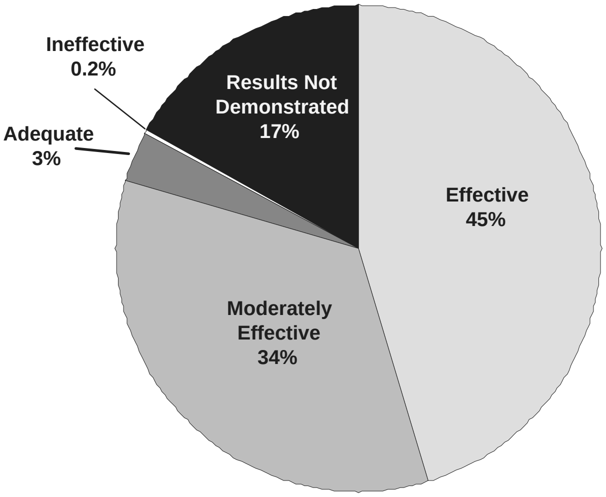
As discussed throughout the 2005 Budget, OMB and the agencies have been working on other initiatives as part of the President's Management Agenda. To support the Budget and Performance Integration initiative, OMB developed a tool to assess the effectiveness of programs consistently: the Program Assessment Rating Tool (PART). Last year the effort included a version of the PART to specifically assess R&D programs, but PART assessments were done in isolation of the R&D Investment Criteria initiative. This year, the R&D PART was modified to align with the R&D criteria. In the process, the R&D PART became the instrument for assessing management and performance at the program level. In preparation of the 2005 Budget, OMB and the agencies completed or updated PART assessments of 58 R&D programs.

Some programs rated "effective" were provided added funding to further the work they do. For example, the Budget requests $305 million for the National Science Foundation's Nanoscale Science and Engineering, an increase of 20 percent from the 2004 likely enacted level. Other examples include: DOE's Basic Energy Science

Program, the National Aeronautics and Space Administration's Mars Exploration Program, and the Department of Commerce's laboratories at the National Institute of Standards and Technology. Other programs that were rated "ineffective" were cut, such as DOE's Oil Technology program. However, funding changes and management reforms are not made by formula or based solely on PART results. For example, funding may be reduced for "effective" programs that have achieved what they set out to, and "ineffective" programs might receive more money if it is clear it would help them become more effective. The PART provides information that permits informed decisions.

Chart 5-2. PART Assessments of 58 R&D Programs

(Share of Total Funding Assessed)



OMB will continue to work with the R&D agencies and others to integrate the R&D criteria more meaningfully into the budget formulation process in the coming year, and to clarify expectations for using the R&D Investment Criteria across the agencies. Based on lessons learned and other feedback from experts and stakeholders, the Administration will continue to improve the R&D investment criteria and their implementation to achieve more effective management of R&D programs and better-informed budget-allocation decisions across the R&D agencies.

President's Management Agenda Initiative

Better Research and Development (R&D) Investment Criteria

FY 2004, Quarter 1 Status: RED, Progress: YELLOW

The initiative's red status score reflects the limited success many agencies have had in the government-wide implementation of the initiative. The yellow progress score indicates that the initiative retains momentum, as some agencies have made improvements this year, including the National Science Foundation, NASA, and DOE. More R&D agencies are using the criteria to assess their programs, due to the improved alignment of the R&D investment criteria with the R&D PART for program-level assessments. Twelve of the top 13 R&D agencies are using the R&D PART to assess their programs this year, up from seven last year. Most of the major R&D agencies submitted 2005 Budget requests that, to varying degrees, observe the principles of the investment criteria. To achieve a yellow status score, half of the R&D programs assessed for each agency must receive at least a "moderately effective" rating, which is proving to be a challenging requirement. Agencies must also integrate the R&D criteria framework into their budget proposals, including using detailed criteria-based assessments to justify specific requests or allocation changes.

Research Earmarks

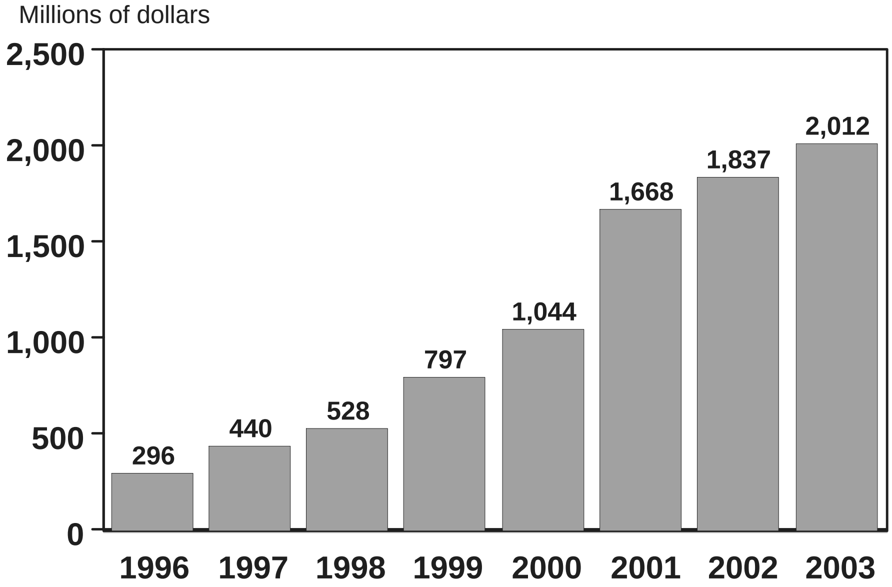
The Administration supports awarding research funds based on merit review through a competitive process. Such a system ensures that the best research is supported. Research earmarks—in general the assignment of money during the legislative process for use only by a specific organization or project—are counter to a merit-based competitive selection process. The use of earmarks improperly signals to potential investigators that there is an alternative to creating quality research proposals for merit-based consideration, including the use of political influence or appeals to parochial interests.

Moreover, the practice of earmarking funds directly to colleges and universities for specific research projects has expanded dramatically in recent years. Despite broad-based support for merit review, earmarks for specific projects at colleges and universities have yet again broken prior records. According to *The Chronicle of Higher Education*, academic earmarks have steadily increased from a level of $296 million in 1996 to over $2 billion in 2003. These funds now form a greater share of the total Federal funding to colleges and universities, and increasingly displace competitive research that is awarded by merit. For example, in 2003, academic earmarks accounted for eight percent of all Federal funding to colleges and universities, which is quite high relative to the 1996 level of 2.5 percent.

Some argue that earmarks help spread the research money to states or institutions that would receive less research funding through other means. *The Chronicle of Higher Education* reports that this is not the main role they play; often only a minor portion of academic earmark funding goes to the states with the smallest shares of Federal research funds. Meanwhile, earmarks help some rich institutions become richer. In 2003, 17 of the 30 institutions receiving the most Federal earmarks were also among the 100 that received the most research funds from all sources.

Some proponents of earmarking assert that earmarks provide a means of funding unique projects that would not be recognized by the conventional peer-review process. To address this concern, a number of agencies have procedures and programs to reward out-of-the-box thinking in the research they award. For example, within the Department of Defense (DOD), the Defense Advanced Research Projects Agency seeks out high risk, high payoff scientific proposals, and program managers at NSF set aside a share of funding for higher-risk projects in which they see high potential.

Chart 5-3. Funding for Academic Earmarks



Many earmarks have little to do with an agency's mission. For example, the Congress earmarked DOD's 2004 budget to fund research on a wide range of diseases, including breast cancer, ovarian cancer, prostate cancer, diabetes, leukemia, and polio. Funding at DOD for such research totals over two-thirds of a billion dollars in 2004 alone. While research on these diseases is very important, it is generally not unique to the U.S. military and can be better carried out and coordinated within civil medical research agencies, without disruption to the military mission. At the same time, intrusion of earmarks into the peer-review processes of civilian medical research agencies would have a significant detrimental impact on funding the most important and promising research.

The Administration will continue to work with academic organizations, colleges and universities, and the Congress to discourage the practice of research earmarks and to achieve our common objectives.

III. PRIORITIES FOR FEDERAL RESEARCH AND DEVELOPMENT

The 2005 Budget requests $132 billion for Federal R&D funding, a $41 billion increase since the beginning of this Administration (Table 5–2 provides details by agency). This is a 44-percent increase over four years. Even if military R&D is excluded, the Administration has raised civilian R&D investment 26 percent over this same period. The 2005 Budget targets key basic research investments within agencies such as NSF, DOE's Office of Science, DOC's National Institute of Standards and Technology, and the National Institutes of Health (NIH), increasing basic research funding across all agencies by $6 billion (29 percent) since 2001.

In a 1995 report from the National Academy of Sciences, the scientific community proposed a "Federal Science and Technology" (FS&T) budget to highlight the creation of new knowledge and technologies more consistently and accurately than the traditional R&D data collection. Also, because the FS&T budget emphasizes research, it does not include funding for defense development, testing, and evaluation, and totals less than half of Federal R&D spending. FS&T is readily tracked through the budget and appropriations process, so the effects of budget decisions are clearer more immediately. As shown in Table 5–3, the 2005 Budget requests $60.4 billion for FS&T, a 27-percent increase since 2001.

Over the past year, OSTP and OMB have worked with the Federal agencies and the science community to identify top priorities for Federal R&D. These are in areas critical to the Nation, such as information technologies, and in emerging fields, such as nanotechnology, that will provide new breakthroughs across many fields. Some priorities, such as combating terrorism R&D, address newly recognized needs. The discussion below identifies five multi-agency priority areas, followed by highlights of agency-specific R&D priorities.

Multi-Agency R&D Priorities

The 2005 Budget targets investments in important research and innovation that benefits from specialization and improved coordination across multiple agencies. Three of these multi-agency initiatives—nanotechnology, information technology R&D, and climate change science—have dedicated separate coordination offices to ensure unified strategic planning and implementation. The Administration is strengthening interagency coordination for other priority areas—such as combating bioterrorism. The Administration will continue to analyze other areas of critical need that could benefit in the future from improved focus and coordination among agencies.

Combating Terrorism R&D: With the creation of the Department of Homeland Security (DHS), 2003 marked a fundamental change to the management of the Nation's investment in combating terrorism R&D. Research programs from across the Federal Government were brought together and focused with the specific goal to develop systems to help prevent future terrorist activities, minimize our Nation's vulnerability to terrorist acts, and respond and recover if an attack should occur. In addition to the DHS R&D funding (about $1 billion in 2005), substantial combating terrorism programs exist in the Departments of Health and Human Services (HHS—over $1.7 billion in 2005), Energy, Defense, Commerce, and Justice, as well as the National Science Foundation and Environmental Protection Agency (EPA).

In 2003, there was significant progress in multi-agency efforts, including:

- BioWatch, a collaborative effort of DHS, HHS, and EPA, which employs environmental sampling devices in 31 cities across the Nation to quickly detect hazardous biological releases in time to distribute life-saving pharmaceuticals to affected persons.
- Project BioShield—A Presidential initiative that will speed development and procurement of new medical countermeasures against current and future terrorist threats. The Administration is coordinating research agendas and generating requirements and acquisition plans for the next generation of medical countermeasures to biological, chemical, and radiological/nuclear threat agents.
- Atmospheric plume modeling and validation was enhanced by a joint effort of DHS, DOD, and DOE in a month-long atmospheric aerosol dispersion study in Oklahoma City. The resulting data and models will help emergency management, law enforcement, and other personnel to train for and respond to potential chemical, biological, or radiological events.
- Demonstration of radiological and nuclear detection was deployed in the New York City metropolitan area (tunnels, bridges, ports, and airports). This demonstration used state-of-the-art detectors from DOE with operations support by DHS and the City of New York, and serves as a model for deploying these technologies in other urban settings.
- DHS initiated a development program for protection of commercial aircraft against surface-to-air missles (Man-Portable Air Defense Systems), following an interagency effort that included the Departments of Defense, Transportation, Justice, and State, and the intelligence community. DHS has solicited and selected projects to address this research effort.

The National Science and Technology Council's (NSTC) Committee on Homeland and National Security is working with the Homeland Security Council and the National Security Council to identify priorities for and facilitate planning among Federal departments and agencies involved in homeland security R&D. The coordinated Federal effort is developing: strategies to combat weapons of mass destruction; radiological and nuclear countermeasures; biological agent detection, diagnostics, therapeutics, and forensics; social, behavioral, and economic aspects of combating terrorism; and border entry/exit technologies.

Networking and Information Technology R&D: The budget provides $2.0 billion for the multi-agency Networking and Information Technology Research and Development (NITRD) program. Networking and information technologies enable advances in other fields and provide capabilities that are utilized by virtually every sector of the economy, generating not only new products and tools but also significant improvements in productivity. Agencies with NITRD investments work together to coordinate their programs and leverage each others' resources, which enables more rapid advancement than they could achieve working on their own. Recent accomplishments of the NITRD program are helping to support progress towards some of the Nation's highest priorities, including defense and homeland security. For example, research on the incorporation of microsensors into wireless networks has implications not only for battlefield reconnaissance but also for environmental monitoring, and may also be used to improve the tools that first responders depend upon for communication in the field. The development of grid computing for accessing and managing distributed information technology resources is another example where NITRD research is influencing the information technology industry.

High-end computing continues to be a major focus of interagency coordination efforts. In 2003, agencies with responsibilities for high-end computing formed the High-End Computing Revitalization Task Force and have worked to develop an interagency R&D roadmap for high-end computing core technologies, a Federal high-end computing capacity and accessibility improvement plan, and recommendations relating to Federal procurement of high-end computing systems. The NITRD interagency working group has taken the first steps toward implementing task force recommendations, and it will continue to leverage the work of the Task Force in improving interagency coordination of high-end computing activities and investments.

Nanotechnology R&D: The budget provides $886 million for the multi-agency National Nanotechnology Initiative (NNI), a three-percent increase over likely enacted funding in 2004. The NNI focuses on R&D that is directed toward understanding and creating materials, devices, and systems that exploit the fundamentally distinct properties of matter as it is manipulated at the atomic and molecular levels. The results of NNI-supported R&D could lead to breakthroughs in disease detection and treatment, manufacturing at the nanoscale, environmental monitoring and protection, energy production and storage, and electronic devices with even greater capabilities than those available today.

Last year the President signed the 21st Century Nanotechnology Research and Development Act, which codified programs and activities supported by the NNI. Consistent with this legislation, in 2005, the Initiative will continue to focus on fundamental and applied research through investigator-led activities, multidisciplinary centers of excellence, education and training of nanotechnology workers, and infrastructure development, including user facilities and networks that are broadly available to researchers from across the scientific research community. In addition to supporting advancement of scientific and technical knowledge and understanding, as well as development of useful applications, the NNI will continue to promote activities aimed at assessing the societal implications of nanotechnology, including ethical, legal, environmental, and workforce-related issues.

Last year the President's Council of Advisors on Science and Technology (PCAST) was tasked with reviewing the multi-agency nanotechnology R&D program, articulating a strategic plan for the program, defining specific grand challenges to guide the program, and identifying metrics for measuring progress toward those grand challenges. In response, PCAST examined the status of nanotechnology R&D generally and the NNI in particular. PCAST will deliver an initial report in 2004 providing recommendations to further strengthen the Initiative.

Climate Change R&D: In July 2003, the Administration released the Strategic Plan for the Climate Change Science Program (CCSP). The Plan provides a 10-year strategy and establishes near-term priorities consistent with the President's Climate Change Research Initiative, which focuses on reducing significant uncertainties in climate science, improving global climate observing systems, and developing resources to support policymaking and resource management.

To achieve the goals outlined in the Strategic Plan, the 2005 Budget includes $57 million of the $103 million in targeted funding committed over two years to accelerate efforts to advance understanding of the role of aerosols in climate science, better quantify carbon sources and sinks, and improve the technology and infrastructure used to observe and model climate variations. These investments will help address critical knowledge gaps in climate change science.

In November 2003, the Administration's Climate Change Technology Program (CCTP) released two reports. The first, CCTP's *Research and Current Activities* report, highlights several Administration initiatives and other areas of ongoing technology R&D that can help reduce greenhouse gas emissions. The CCTP's more comprehensive *Technology Options for the Near and Long Term* is a compendium of technology profiles and ongoing R&D at participating Federal agencies.

The CCTP continues to examine the portfolio of federally funded climate change technology R&D and to develop a strategic plan to coordinate and prioritize these activities, consistent with the President's National Climate Change Technology Initiative (NCCTI). The 2005 Budget continues support for a NCCTI Competitive Solicitation program, a unique approach to selecting and funding innovative research ideas based on their potential to reduce, avoid, or sequester greenhouse gases. The program will enhance and complement the ongoing base of climate change technology R&D.

Hydrogen R&D: The Hydrogen R&D Interagency Task Force, established by OSTP shortly after the President's announcement of the Hydrogen Fuel Initiative, serves as the mechanism for collaboration among the nine Federal agencies that fund hydrogen-related R&D. In 2003, the task force gathered information and provided guidance for agency research directions. In 2004, the task force will complete an interagency 10-year plan that will improve coordination of agency efforts, accelerate progress toward the goals of the initiative, and foster collaboration between the Federal Government and the private sector, state agencies, and other stakeholders. The DOE-led International Partnership for the Hydrogen Economy coordinates hydrogen research between the U.S. and other participating governments.

Agency R&D Highlights

Each Federal agency conducts R&D in the context of that agency's unique mission, structure, and statutory requirements. Below are highlights of key programs in selected agencies in the 2005 Budget. Table 5–3 shows the FS&T budget. As shown in Table 5–2, these programs and those of other agencies are part of the larger Federal R&D portfolio.

National Institutes of Health (NIH): The 2005 Budget provides $28.6 billion for NIH, a 2.6-percent increase over the 2004 likely enacted level. This level is an $8.2 billion (40.5-percent) increase since 2001.

- The Administration has demonstrated its strong commitment to biomedical research by completing a five-year doubling of the NIH budget.
- NIH continues to play a key role in addressing pressing health research issues, such as access

to state-of-the-art instrumentation and biomedical technologies; development of specialized animal and non-animal research models; and emphasis on "smart" network-connected technologies, computer-aided drug design, gene and molecular therapy development, and bioengineering approaches to decreased health care costs.

- In addition, the NIH budget continues support for biodefense research by providing $1.74 billion for NIH to accelerate clinical trials, target the development of new therapeutic and vaccine products for agents of bioterrorism, and establish Regional Centers of Excellence in Biodefense and Emerging Infectious Diseases.

National Aeronautics and Space Administration (NASA): The 2005 Budget provides $9.4 billion for FS&T programs at NASA, a 1.3-percent increase over the 2004 likely enacted level. This is a 35-percent increase since 2001.

- The 2005 Budget supports the President's new vision of sustained solar system exploration involving both humans and robots. NASA's FS&T programs will increasingly focus on this vision, which includes:
  —a new program of lunar exploration;
  —further robotic exploration of the solar system;
  —focused exploration of Mars to accelerate the search for water and life and to prepare for future human exploration;
  —development of technologies to support human and robotic space exploration; and
  —refocused Space Station research on activities that support space-exploration goals.
- The budget also supports increased NASA investments in the President's Climate Change Research Initiative, including investment in a critical satellite to help determine the impact of aerosols such as soot and dust on global climate change.
- The budget supports several new major initiatives in aeronautics R&D, including a five-year $600 million program to improve the efficiency of aircraft propulsion systems.
- PART assessments found NASA's Mars and Solar System exploration programs to be effective and the agency's crosscutting technology R&D to be moderately effective. The PART determined that the Space Station Program, Space Station R&D, and the Space Shuttle Program need to develop better performance goals and demonstrate results.

National Science Foundation (NSF): To further promote research and education across the fields of science and engineering, the 2005 Budget provides $5.7 billion for NSF, a three-percent increase over the 2004 likely enacted level. This level is a 30-percent increase since 2001.

- The budget provides: $761 million for NSF's lead role in NITRD, focusing on long-term computer science research and applications; $305 million for NSF's lead role in the National Nanotechnology Initiative; and $210 million for climate change science.
- The budget provides $1.1 billion for NSF programs that emphasize the mathematical and physical sciences, including physics, chemistry, and astronomy. This represents a 31-percent increase ($261 million) for these programs since 2001.
- To attract the most promising students into the sciences, the 2005 Budget provides funds for 5,500 graduate research fellowships and traineeships, an increase of 1,800 since 2001. Annual stipends in these programs have increased to a projected $30,000, compared with $18,000 in 2001.
- To enhance science infrastructure capabilities, the Budget initiates construction of the National Ecological Observatory Network, the Scientific Ocean Drilling Vessel, and the Rare Symmetry Violating Processes (RSVP) facility.
- PART assessments found all four of the NSF programs assessed to be effective: Facilities, Individuals, Nanoscale Science and Engineering, and Information Technology Research.

Department of Energy (DOE): The 2005 Budget provides $5.4 billion for FS&T at DOE, a $492 million (or 10-percent) increase since 2001.

- DOE will continue the President's Hydrogen Fuel Initiative to accelerate the worldwide availability and affordability of hydrogen-powered fuel cell vehicles. The initiative, which will now include targeted basic research investments, focuses on research to advance hydrogen production, storage, and infrastructure. The Initiative complements the Department's FreedomCAR Partnership with the auto industry, which is aimed at developing viable hydrogen fuel cell vehicle technology.
- The 2005 Budget provides $3.4 billion for the Office of Science, including funding to ensure its continuing leadership in physical science research and its unique research in genomics, climate change, and supercomputing. The fifth and final nanoscience research center will begin construction as a part of the Office's $211 million investment in the National Nanotechnology Initiative.
- The budget dedicates $447 million to the President's Coal Research Initiative on clean coal technologies, including $237 million for FutureGen which will be the world's first zero-emissions electricity-producing power plant. This 10-year, $1 billion project will be cost-shared by the private sector and international participants.
- DOE will continue its support for R&D to improve energy efficiency and reliability in buildings, industry, transportation, and the Federal Government ($544 million), and to reduce the cost of renewable energy technologies, such as wind, solar, geothermal, and biomass ($375 million).
- The budget provides $34 million for the Generation IV Nuclear Energy Systems Initiative and $46 million for the Advanced Fuel Cycle Initiative to develop next-generation nuclear reactor and fuel

cycle technologies that are sustainable, proliferation-resistant, and economical.

- The budget includes $91 million for electricity transmission and distribution reliability R&D activities, a 12-percent increase over 2004. These funds include $45 million for high temperature superconductivity, $6 million for the new Gridworks program to support research that will enable power lines to carry more power and better control the flow of electricity to prevent blackouts, and $5 million for the Gridwise program to improve the communications and control system for the electricity grid.

Department of Defense (DOD): DOD funds a wide range of R&D to ensure that our military forces have the tools to protect the Nation's security. In 2005, DOD's budget includes $5.2 billion that appears in the FS&T budget. This level is a $225 million (4.6-percent) increase since 2001.

- The 2005 Budget funds "Science and Technology" programs to explore and develop technical options for new defense systems and to avoid being surprised by new technologies in the hands of adversaries. Areas of emphasis include computing and communications, sensors, nanotechnology, and hypersonic propulsion systems. DOD's S&T includes the research counted in the FS&T budget, plus advanced technology development.
- The Missile Defense Agency continues to develop technologies for intercepting ballistic missiles in multiple phases of flight. The budget provides funding for missile defense R&D, which includes new efforts for high-speed, boost-phase interceptors, sea-based radars, directed energy technology and advanced battle management systems.
- The Army continues development efforts in support of the Future Combat System as a major part of its transformation to a lighter, more mobile, and more effective fighting force.
- Development continues on the Joint Strike Fighter, the next generation affordable multi-role fighter aircraft, which will use innovative technologies to keep costs low.
- The Navy continues development of the next generation DD(X) destroyer, the Littoral Combat Ship and associated shipboard technologies. These platforms will provide advanced capabilities that will ensure U.S. naval superiority continues into the future.
- R&D to address terrorist and other unconventional threats continue to be a high priority. Systems and technologies under development to address defense against chemical or biological agents include: improved detectors of chemical and biological threats; troop protective gear for use under chemical and biological attack that is both more effective and more comfortable; and vaccines to protect against biological agents.

Department of Agriculture (USDA): The 2005 Budget provides $1.9 billion for FS&T at USDA.

- Funding for the Agricultural Research Service includes increases in high priority areas, such as homeland security (food safety and emerging and exotic diseases), genomics and genetics, human nutrition, and the establishment of a National Plant Disease Recovery System.
- The Cooperative State Research, Education, and Extension Service funding for research and education grants includes $180 million for the National Research Initiative, an increase of $16 million (10 percent) over 2004, and $30 million for the network of university-based diagnostic laboratories. The budgets for both in-house research and research grants do not continue funding for unrequested earmarks.
- The Economic Research Service budget includes increases totaling $7 million to study consumer behavior, particularly dietary attitudes, food consumption, and health awareness.
- The budget includes an emphasis on putting forestry research to work, providing a significant increase to optimize the delivery of research findings by improving Forest Service management of investments in research, development, and technology applications. Funds are also provided for research on rapid management responses to address threats against forest and rangeland health and agriculture by invasive species.

Department of the Interior (DOI): Within the Department of the Interior, the 2005 Budget provides $920 million for the United States Geological Survey (USGS). USGS provides science and information for DOI bureaus and local communities to make informed decisions regarding land and resource management. In 2005 some areas of focus for USGS include:

- Work with at-risk jurisdictions to increase the number that have adopted hazard mitigation measures based on USGS geologic hazard information, and coordination with Federal partners to determine the effectiveness of Federal efforts to reduce the loss of life and property due to geologic hazards.
- Expansion of USGS capabilities to monitor ground deformations with remote sensing technology, InSAR, to assist in predicting volcanic activity.
- Additional water availability and aquifer characterization studies to support DOI's Water 2025, and an additional $2 million to provide critical information about water quality and quantity and fish ecology that is necessary for management of the Klamath River Basin.
- Consistent with 2004 PART findings, USGS is restructuring the Geography program in order to migrate from its traditional role as the primary data collector and producer of topographic maps to one that focuses on data sharing and partnerships. Workforce restructuring will provide savings in 2004 and 2005 to fund partnerships to

develop needed science and applications to promote geographic integration and analyses.

Department of Commerce (DOC): The 2005 Budget provides $832 million for FS&T at the Department of Commerce.

- For the National Institute of Standards and Technology (NIST), the budget provides $482 million for research and physical improvements at NIST's Measurement and Standards Laboratories. The budget also supports NIST facilities, including equipment for the Advanced Measurement Laboratory in Maryland and renovations of facilities in Boulder, Colorado.
- The 2005 Budget proposes to terminate the Advanced Technology Program (ATP). The Administration believes that other NIST research and development programs are much more effective and necessary in supporting the fundamental scientific understanding and technological needs of U.S.-based businesses, American workers, and the domestic economy. Further, large shares of ATP funding have gone to major corporations, and projects often have been similar to those being carried out by firms not receiving such subsidies.
- For the National Oceanic and Atmospheric Administration (NOAA) the 2005 Budget provides $350 million for ongoing research on climate, weather, air quality, and ocean processes. This funding level includes $19 million for NOAA to expand climate observing capabilities in support of the Administration's recently released Climate Change Science Program (CCSP) Strategic Plan.

Department of Veterans Affairs (VA): The 2005 Budget provides $770 million for FS&T at the Department of Veterans Affairs. This level is a seven-percent increase since 2001. This will provide level funding to the VA R&D program after taking into consideration the significant funding the Department receives from other governmental agencies and private entities to support VA-conducted research. The total VA R&D program resources are $1.7 billion.

- VA will soon begin to use increased funding from private companies for the indirect administration costs of conducting research in VA facilities.
- The 2005 Budget provides for clinical, epidemiological, and behavioral studies across a broad spectrum of medical research disciplines. Among the agency's top research priorities are improving the translation of research results into patient care, special populations (those afflicted with spinal cord injury, visual and hearing impairments, and serious mental illness), geriatrics, diseases of the brain (e.g., Alzheimer's and Parkinson's), treatment of chronic progressive multiple sclerosis, and chronic disease management.
- The 2005 Budget reflects a restructuring of total resources in the Research Business Line as first shown in the 2004 Budget.

Environmental Protection Agency (EPA): The budget provides $725 million for FS&T for the Environmental Protection Agency to ensure that its efforts to safeguard human health and the environment are based on the best available scientific and technical information.

- EPA's homeland security research will result in more efficient and effective cleanup of contaminated buildings and faster threat detection and response for water systems. Additionally, EPA will develop practices and procedures that provide elected officials and other decision makers, the public, and first responders with rapid risk assessment protocols for chemical and biological threats.
- As part of its Water Quality Monitoring initiative, EPA will address the integration of different scales and types of monitoring to target effective water quality management actions and document effectiveness of water quality management programs.

Department of Transportation (DOT): The 2005 Budget provides $659 million for FS&T at DOT, a $138 million (26.5-percent) increase since 2001.

- The Federal Highway Administration ($429 million in 2005) supports research, technology, and education to improve the quality and safety of the Nation's transportation infrastructure, such as increasing the quality and longevity of roadways, identifying safety improvements, and promoting congestion mitigation through the use of Intelligent Transportation Systems.
- The budget of the National Highway Traffic Safety Administration provides $103 million for R&D in crash-worthiness, crash avoidance, and data analysis to help reduce highway fatalities and injuries. The budget also includes funding for a crash causation survey.
- In 2005, R&D at the Federal Motor Carrier Safety Administration focuses on issues including driver safety performance, commercial vehicle safety performance, carrier compliance and safety, and other studies toward the goal of achieving a substantial reduction in crashes and fatalities.
- The 2005 Budget provides $117 million for the Federal Aviation Administration to continue critical safety and capacity research. The PART assessment found this program to be effective; it is well-managed and results-oriented, with a strategic plan that sets forth clear long-term goals that are tied to program performance measures.

Department of Education: The 2005 Budget provides $370 million for research activities at the Department of Education, a $20 million increase over the 2004 likely enacted level.

- The Institute of Education Sciences (IES) has the lead responsibility for the Department's strategic goal of transforming education into an evidence-based field. Research, development, and dissemination ($185 million in 2005) supports research to advance our understanding of how students learn and identify effective approaches and interventions to improve education.

- Research and innovation in special education activities ($78 million in 2005) yield new knowledge and help translate scientifically valid information into applied strategies. The 2005 PART showed that the program does not have specific long-term outcome goals against which its impact can be measured. The program is working to articulate long-term research objectives that have measurable outcomes. Pending legislation would transfer this program from the Office of Special Education Programs to IES to promote better coordination.
- The National Institute for Disability Rehabilitation and Research (NIDRR—$107 million in 2005) conducts research, demonstration and training activities that advance independent living for people with disabilities. Consistent with the President's New Freedom Initiative, NIDRR's activities promote community integration and employment outcomes. The 2005 PART showed that NIDRR cannot demonstrate the results of its investments without long term performance measures. In response to this finding, NIDRR is developing long-term research goals that have measurable outcomes.

Department of Homeland Security (DHS): The 2005 Budget requests just over one billion dollars for DHS R&D. Within DHS, the Directorate of Science and Technology (S&T) serves as a centralized R&D arm that consolidates piecemeal R&D efforts into one agency. Its sole focus is to harness revolutionary technology, which can be used by law enforcement and emergency response personnel in carrying out their mission to protect the Nation. S&T works to solicit proposals and seeks to engage our Nation's well-established R&D community in the fight against terrorism. S&T has separate offices dedicated to addressing the threat posed by each major category of weapons of mass destruction, such as chemical, biological, radiological, nuclear, and high-explosives.

Stimulating Private Investment

Along with direct spending on R&D, the Federal Government has sought to stimulate private R&D investment through tax preferences. Current law provides a 20-percent tax credit for private research and experimentation expenditures above a certain base amount. The credit, which expired in 1999, was retroactively reinstated for five years, through 2004, in the Tax Relief Extension Act of 1999. The budget proposes to make the Research and Experimentation (R&E) tax credit permanent. The proposed extension will cost nearly $30 billion over the period from 2005 to 2009. In addition, a permanent tax provision lets companies deduct, up front, the costs of certain kinds of research and experimentation, rather than capitalize these costs. Also, equipment used for research benefits from relatively rapid cost recovery. Table 5–1 shows a forecast of the costs of the tax credit.

Table 5–1. PERMANENT EXTENSION OF THE RESEARCH AND EXPERIMENTATION TAX CREDIT

(Budget authority, dollar amounts in millions)

	2004	2005	2006	2007	2008	2009	2005–09
Current Law	4,400	2,550	1,090	460	150	60	4,310
Proposed Extension	672	3,610	5,187	6,291	7,129	7,775	29,992
Total	**5,072**	**6,160**	**6,277**	**6,751**	**7,279**	**7,835**	**34,302**

IV. FEDERAL R&D DATA

Federal R&D Funding

R&D is the collection of efforts directed towards gaining greater knowledge or understanding and applying knowledge toward the production of useful materials, devices, and methods. R&D investments can be characterized as basic research, applied research, development, R&D equipment, or R&D facilities, and OMB has used those or similar categories in its collection of R&D data since 1949.

Basic research is defined as systematic study directed toward greater knowledge or understanding of the fundamental aspects of phenomena and of observable facts without specific applications towards processes or products in mind.

Applied research is systematic study to gain knowledge or understanding necessary to determine the means by which a recognized and specific need may be met.

Development is systematic application of knowledge toward the production of useful materials, devices, and systems or methods, including design, development, and improvement of prototypes and new processes to meet specific requirements.

Research and development equipment includes acquisition or design and production of movable equipment, such as spectrometers, microscopes, detectors, and other instruments.

Research and development facilities include the acquisition, design, and construction of, or major repairs or alterations to, all physical facilities for use in R&D activities. Facilities include land, buildings, and fixed capital equipment, regardless of whether the facilities are to be used by the Government or by a private organization, and regardless of where title to the property may rest. This category includes such fixed facilities as reactors, wind tunnels, and particle accelerators.

There are over twenty Federal agencies that fund R&D in the U.S. The nature of the R&D that these agencies fund depends on the mission of each agency and on the role of R&D in accomplishing it. Table 5–2 shows agency-by-agency spending on basic and applied research, development, and R&D equipment and facilities.

Table 5–2. FEDERAL RESEARCH AND DEVELOPMENT SPENDING

(Budget authority, dollar amounts in millions)

	2003 Actual	2004 Estimate	2005 Proposed	Dollar Change: 2004 to 2005	Percent Change: 2004 to 2005
By Agency					
Defense	58,838	65,484	69,856	4,372	7%
Health and Human Services	27,411	28,275	29,381	1,106	4%
NASA	10,681	10,893	11,308	415	4%
Energy	8,312	8,835	8,893	58	1%
National Science Foundation	3,972	4,115	4,252	137	3%
Agriculture	2,334	2,308	2,105	–203	–9%
Homeland Security	737	1,053	1,216	163	15%
Commerce	1,200	1,126	1,075	–51	–5%
Veterans Affairs	819	824	772	–52	–6%
Transportation	701	701	749	48	7%
Interior	643	675	648	–27	–4%
Environmental Protection Agency	568	575	577	2	0%
Other	1,223	1,092	1,034	–58	–5%
Total	**117,439**	**125,956**	**131,866**	**5,910**	**5%**
Basic Research					
Defense	1,369	1,404	1,341	–63	–4%
Health and Human Services	14,120	14,732	15,198	466	3%
NASA	2,213	2,584	2,324	–260	–10%
Energy	2,556	2,750	2,664	–86	–3%
National Science Foundation	3,422	3,551	3,642	91	3%
Agriculture	867	914	783	–131	–14%
Homeland Security	47	47	153	106	226%
Commerce	54	57	83	26	46%
Veterans Affairs	327	332	308	–24	–7%
Transportation	23	20	40	20	100%
Interior	41	40	38	–2	–5%
Environmental Protection Agency	97	79	91	12	15%
Other	170	165	182	17	10%
Subtotal	**25,306**	**26,675**	**26,847**	**172**	**0.6%**
Applied Research					
Defense	4,252	4,425	3,828	–597	–13%
Health and Human Services	11,982	13,174	13,522	348	3%
NASA	3,192	3,052	3,122	70	2%
Energy	2,656	3,020	3,395	375	12%
National Science Foundation	218	211	220	9	4%
Agriculture	974	1,049	888	–161	–15%
Homeland Security	92	124	278	154	124%
Commerce	910	891	838	–53	–6%
Veterans Affairs	451	450	425	–25	–6%
Transportation	405	398	455	57	14%
Interior	547	584	560	–24	–4%
Environmental Protection Agency	366	361	346	–15	–4%
Other	579	609	617	8	1%
Subtotal	**26,624**	**28,348**	**28,494**	**146**	**0.5%**

Table 5–2. FEDERAL RESEARCH AND DEVELOPMENT SPENDING—Continued

(Budget authority, dollar amounts in millions)

	2003 Actual	2004 Estimate	2005 Proposed	Dollar Change: 2004 to 2005	Percent Change: 2004 to 2005
Development					
Defense	53,172	59,603	64,622	5,019	8%
Health and Human Services	160	140	386	246	176%
NASA	2,963	2,994	3,247	253	8%
Energy	1,946	1,956	1,840	–116	–6%
National Science Foundation	....	....	....	....	N/A
Agriculture	145	152	142	–10	–7%
Homeland Security	549	794	750	–44	–6%
Commerce	135	128	53	–75	–59%
Veterans Affairs	41	42	39	–3	–7%
Transportation	254	270	235	–35	–13%
Interior	53	48	47	–1	–2%
Environmental Protection Agency	105	135	140	5	4%
Other	460	311	228	–83	–27%
Subtotal	**59,983**	**66,573**	**71,729**	**5,156**	**8%**
Facilities and Equipment					
Defense	45	52	65	13	25%
Health and Human Services	1,149	229	275	46	20%
NASA	2,313	2,263	2,615	352	16%
Energy	1,154	1,109	994	–115	–10%
National Science Foundation	332	353	390	37	10%
Agriculture	348	193	292	99	51%
Homeland Security	49	88	35	–53	–60%
Commerce	101	50	101	51	102%
Veterans Affairs	....	....	....	....	N/A
Transportation	19	13	19	6	46%
Interior	2	3	3	....	....
Environmental Protection Agency	....	....	....	....	N/A
Other	14	7	7	....	....
Subtotal	**5,526**	**4,360**	**4,796**	**436**	**10%**

Table 5–3. FEDERAL SCIENCE AND TECHNOLOGY BUDGET

(Budget authority, dollar amounts in millions)

	2001 Actual	2003 Actual	2004 Estimate	2005 Proposed	Dollar Change: 2004 to 2005	Percent Change: 2004 to 2005
By Agency						
National Institutes of Health	**20,361**	**27,066**	**27,878**	**28,607**	**729**	**3%**
NASA [1]	**6,945**	**7,276**	**9,249**	**9,373**	**124**	**1%**
Space Science	2,609	3,531	3,971	4,068	97	2%
Earth Science	1,762	1,717	1,613	1,485	–128	–8%
Biological & Physical Research	362	883	985	1,049	64	6%
Aeronautics Technology	975	1,145	1,034	919	–115	–11%
Exploration Systems and Crosscutting Technology [2]	1,237	1,741	1,646	1,852	206	13%
National Science Foundation	**4,431**	**5,323**	**5,578**	**5,745**	**167**	**3%**
Energy [3]	**4,886**	**5,208**	**5,494**	**5,378**	**–116**	**–2%**
Science Programs	3,218	3,307	3,484	3,432	–52	–1%
Energy Supply: Renewables	312	322	357	375	18	5%
Energy Supply: Electricity Transmission & Distribution [4]	56	88	81	91	10	12%
Energy Supply: Nuclear Energy	238	258	292	300	8	3%
Energy Conservation [5]	619	612	607	544	–63	–10%
Fossil Energy [6]	443	621	673	636	–37	–5%
Defense	**4,944**	**5,621**	**5,829**	**5,169**	**–660**	**–11%**
Basic Research	1,271	1,369	1,404	1,341	–63	–4%
Applied Research	3,673	4,252	4,425	3,828	–597	–13%
Agriculture	**1,885**	**1,988**	**2,048**	**1,865**	**–183**	**–9%**
CSREES Research & Education [7]	514	626	629	516	–113	–18%
Economic Research Service	69	69	71	80	9	13%
Agricultural Research Service [8]	936	1,043	1,082	988	–94	–9%
Mandatory IFAFS [9]	120	....	....	....	....	N/A
Forest Service [10]	246	250	266	281	15	6%
Interior (USGS)	**884**	**919**	**938**	**920**	**–18**	**–2%**
Commerce	**817**	**974**	**965**	**832**	**–133**	**–14%**
NOAA (Oceanic & Atmospheric Research)	325	372	393	350	–43	–11%
NIST Intramural Research and Facilities	347	423	401	482	81	20%
NIST Advanced Technology Program	145	179	171	....	–171	–100%
Veterans Affairs [11]	**719**	**818**	**820**	**770**	**–50**	**–6%**
Environmental Protection Agency [12]	**746**	**801**	**826**	**725**	**–101**	**–12%**
Transportation	**521**	**655**	**683**	**659**	**–24**	**–4%**
Highway research [13]	387	508	564	542	–22	–4%
Aviation research [14]	134	147	119	117	–2	–2%
Education	**363**	**325**	**350**	**370**	**20**	**6%**
Special Education Research and Innovation	77	77	78	78	....	....
NIDRR [15]	100	109	107	107	....	....
Research, Development, and Dissemination [16]	186	139	165	185	20	12%
Total	**47,502**	**56,974**	**60,658**	**60,413**	**–245**	**–0.4%**

[1] All years normalized to reflect 2003 transfers of funding for Space Station research facilities, space communications activities, and associated institutional support from human space flight.

[2] Includes Integrated Technology Transfer Partnerships, Mission and Science Measurement Technology, and the Space Launch Initiative.

[3] 2001 and 2003 data reflect transfers to Science Programs from other Department of Energy R&D programs to support the Small Business Innovation Research program and the Small Business Technology Transfer program.

[4] This office was created in 2004. Data for 2001 and 2003 reflect funding for these activities from within the Renewable budget, which has been adjusted accordingly.

[5] Excludes weatherization and state grant programs.

[6] Enacted and requested levels exclude balances transferred from the Clean Coal Technology program for activities in 2003 ($40 million), and 2004 ($14 million). No transfers in 2005.

[7] Includes Receipts for Native American Endowment: $7 million in 2003; $9 million in 2004; $12 million in 2005.

[8] Excludes buildings and facilities.

[9] Initiative for Future Agriculture and Food Systems.

[10] Forest and Rangeland Research.

[11] The VA research program budget has been restructured to include the research appropriation and VA medical care support transfer to research. This table shows resources under the revised budget structure.

[12] Science and Technology, plus superfund transfer. The 2003 superfund transfer includes homeland resources for building decontamination research.

[13] Includes research and development funding for the Federal Highway Administration, the Federal Motor Carrier Safety Administration, and the National Highway Traffic Safety Administration.

[14] Includes Federal Aviation Administration Research, Engineering, and Development.

[15] National Institute on Disability and Rehabilitation Research.

[16] Does not include funding for Regional Educational Labs.

Table 5–4. AGENCY DETAIL OF SELECTED INTERAGENCY R&D EFFORTS

(Budget authority, dollar amounts in millions)

	2003 Actual	2004 Estimate	2005 Proposed	Dollar Change: 2004 to 2005	Percent Change: 2004 to 2005
Networking and Information Technology R&D					
National Science Foundation	743	754	761	7	1%
Health and Human Services [1]	376	368	371	3	1%
Energy	308	344	354	10	3%
National Aeronautics and Space Administration	213	275	259	–16	–6%
Defense	296	252	226	–26	–10%
Commerce	26	26	33	7	27%
Environmental Protection Agency	2	4	4	....	....
Total	**1,964**	**2,023**	**2,008**	**–15**	**–1%**
National Nanotechnology Initiative					
National Science Foundation	221	254	305	51	20%
Energy	134	203	211	8	4%
Defense	220	218	180	–38	–17%
National Institutes of Health	78	80	89	9	11%
Commerce (NIST)	64	63	53	–10	–16%
National Aeronautics and Space Administration	36	37	35	–2	–5%
Agriculture	....	1	5	4	400%
Environmental Protection Agency	5	5	5	....	....
Justice	1	2	2	....	....
Homeland Security (TSA)	1	1	1	....	....
Total	**760**	**864**	**886**	**22**	**3%**
Climate Change Science Program					
National Aeronautics and Space Administration	1,146	1,334	1,271	–63	–5%
National Science Foundation	202	213	210	–3	–1%
Commerce (NOAA)	117	130	142	12	9%
Energy	120	133	134	1	1%
Agriculture	68	67	74	7	10%
National Institutes of Health	59	61	61	....	....
Interior (USGS)	26	28	29	1	4%
Environmental Protection Agency	19	22	21	–1	–5%
Smithsonian	6	6	6	....	....
U.S. Agency for International Development	6	6	6	....	....
Transportation	....	....	3	3	N/A
State	....	1	1	....	....
Total	**1,769**	**2,001**	**1,958**	**–43**	**–2%**
Subtotal, CCRI [2] (included in CCSP total)	**41**	**168**	**238**	**70**	**42%**

[1] Includes funds from offsetting collections for the Agency for Healthcare Research and Quality.

[2] Climate Change Research Initiative.

6. FEDERAL INVESTMENT

Investment spending is spending that yields long-term benefits. Its purpose may be to improve the efficiency of internal Federal agency operations or to increase the Nation's overall stock of capital for economic growth. The spending can be direct Federal spending or grants to State and local governments. It can be for physical capital, which yields a stream of services over a period of years, or for research and development or education and training, which are intangible but also increase income in the future or provide other long-term benefits.

Most presentations in the Federal budget combine investment spending with spending for current use. This chapter focuses solely on Federal and federally financed investment.

In this chapter, investment is discussed in the following sections:

- a description of the size and composition of Federal investment spending;
- a discussion of the performance of selected Federal investment programs; and
- a presentation of trends in the stock of federally financed physical capital, research and development, and education.

Two sections that appeared in this chapter last year, "Alternative Capital Budget and Capital Expenditure Presentations" and "Supplemental Physical Capital Information", are not included this year, primarily because the information in these sections changes little from year to year, and the reader may refer to earlier budgets for this information or analysis.

PART I. DESCRIPTION OF FEDERAL INVESTMENT

For more than fifty years, the Federal budget has included a chapter on Federal investment—defined as those outlays that yield long-term benefits—separately from outlays for current use. In recent years the discussion of the composition of investment has displayed estimates of budget authority as well as outlays.

The classification of spending between investment and current outlays is a matter of judgment. The budget has historically employed a relatively broad classification, encompassing physical investment, research, development, education, and training. The budget further classifies investments into those that are grants to State and local governments, such as grants for highways or education, and all other investments, called "direct Federal programs," in this analysis. This "direct Federal" category consists primarily of spending for assets owned by the Federal Government, such as defense weapons systems and general purpose office buildings, but also includes grants to private organizations and individuals for investment, such as capital grants to Amtrak or higher education loans directly to individuals.

Presentations for particular purposes could adopt different definitions of investment:

- To suit the purposes of a traditional balance sheet, investment might include only those physical assets owned by the Federal Government, excluding capital financed through grants and intangible assets such as research and education.
- Focusing on the role of investment in improving national productivity and enhancing economic growth would exclude items such as national defense assets, the direct benefits of which enhance national security rather than economic growth.
- Concern with the efficiency of Federal operations would confine the coverage to investments that reduce costs or improve the effectiveness of internal Federal agency operations, such as computer systems.
- A "social investment" perspective might broaden the coverage of investment beyond what is included in this chapter to include programs such as childhood immunization, maternal health, certain nutrition programs, and substance abuse treatment, which are designed in part to prevent more costly health problems in future years.

The relatively broad definition of investment used in this section provides consistency over time—historical figures on investment outlays back to 1940 can be found in the separate *Historical Tables* volume. Table 6–2 at the end of this section allows disaggregation of the data to focus on those investment outlays that best suit a particular purpose.

In addition to this basic issue of definition, there are two technical problems in the classification of investment data involving the treatment of grants to State and local governments and the classification of spending that could be shown in more than one category.

First, for some grants to State and local governments it is the recipient jurisdiction, not the Federal Government, that ultimately determines whether the money is used to finance investment or current purposes. This analysis classifies all of the outlays in the category where the recipient jurisdictions are expected to spend most of the money. Hence, the community development block grants are classified as physical investment, although some may be spent for current purposes. General purpose fiscal assistance is classified as current spending, although some may be spent by recipient jurisdictions on physical investment.

Second, some spending could be classified in more than one category of investment. For example, outlays for construction of research facilities finance the acquisition of physical assets, but they also contribute to research and development. To avoid double counting, the outlays are classified in the category that is most commonly recognized as investment. Consequently outlays for the conduct of research and development do not include outlays for research facilities, because these outlays are included in the category for physical investment. Similarly, physical investment and research and development related to education and training are included in the categories of physical assets and the conduct of research and development.

When direct loans and loan guarantees are used to fund investment, the subsidy value is included as investment. The subsidies are classified according to their program purpose, such as construction or education and training. For more information about the treatment of Federal credit programs, refer to Chapter 25, "The Budget System and Concepts," in this volume.

This section presents spending for gross investment, without adjusting for depreciation.

Composition of Federal Investment Outlays

Major Federal Investment

The composition of major Federal investment outlays is summarized in Table 6–1. They include major public physical investment, the conduct of research and development, and the conduct of education and training. Defense and nondefense investment outlays were $345.2 billion in 2003. They are estimated to increase to $376.7 billion in 2004 and are projected to increase further to $390.0 billion in 2005. Major Federal investment outlays will comprise an estimated 16 percent of total Federal outlays in 2005 and 3.2 percent of the Nation's gross domestic product (GDP). Greater detail on Federal investment is available in Table 6–2 at the end of this section. That table includes both budget authority and outlays.

Physical investment. Outlays for major public physical capital investment (hereafter referred to as physical investment outlays) are estimated to be $179.8 billion in 2005. Physical investment outlays are for construction and rehabilitation, the purchase of major equipment, and the purchase or sale of land and structures. More than three-fifths of these outlays are for direct physical investment by the Federal Government, with the remainder being grants to State and local governments for physical investment.

Direct physical investment outlays by the Federal Government are primarily for national defense. Defense outlays for physical investment are estimated to be $85.6 billion 2005. Almost all of these outlays, or an estimated $78.4 billion, are for the procurement of weapons and other defense equipment, and the remainder is primarily for construction on military bases, family housing for military personnel, and Department of Energy defense facilities.

Outlays for direct physical investment for nondefense purposes are estimated to be $31.1 billion in 2005. These outlays include $16.4 billion for construction and rehabilitation. This amount includes funds for water, power, and natural resources projects of the Corps of Engineers, the Bureau of Reclamation within the Department of the Interior, and the Tennessee Valley Authority; construction and rehabilitation of veterans hospitals and Postal Service facilities; facilities for space and science programs, and Indian Health Service hospitals and clinics. Outlays for the acquisition of major equipment are estimated to be $14.1 billion in 2005. The largest amounts are for the air traffic control system. For the purchase or sale of land and structures, disbursements are estimated to exceed collections by $0.6 billion in 2005. These purchases are largely for buildings and land for parks and other recreation purposes.

Grants to State and local governments for physical investment are estimated to be $63.1 billion in 2005. More than two-thirds of these outlays, or $43.8 billion, are to assist States and localities with transportation infrastructure, primarily highways. Other major grants for physical investment fund sewage treatment plants, community development, and public housing.

Conduct of research and development. Outlays for the conduct of research and development are estimated to be $124.0 billion in 2005. These outlays are devoted to increasing basic scientific knowledge and promoting research and development. They increase the Nation's security, improve the productivity of capital and labor for both public and private purposes, and enhance the quality of life. More than half of these outlays, an estimated $71.4 billion, are for national defense. Physical investment for research and development facilities and equipment is included in the physical investment category.

Nondefense outlays for the conduct of research and development are estimated to be $52.6 billion in 2005. These are largely for the National Aeronautics and Space Administration, the National Science Foundation, the National Institutes of Health, and research for nuclear and non-nuclear energy programs.

A more complete and detailed discussion of research and development funding appears in Chapter 5, "Research and Development" in this volume.

Conduct of education and training. Outlays for the conduct of education and training are estimated to be $86.2 billion in 2005. These outlays add to the stock of human capital by developing a more skilled and productive labor force. Grants to State and local governments for this category are estimated to be $51.4 billion in 2005, three-fifths of the total. They include education programs for the disadvantaged and the disabled, vocational and adult education programs, training programs in the Department of Labor, and Head Start. Direct Federal education and training outlays are estimated

Table 6–1. COMPOSITION OF FEDERAL INVESTMENT OUTLAYS

(In billions of dollars)

	2003 Actual	Estimate	
		2004	2005
Federal Investment			
Major public physical capital investment:			
Direct Federal:			
National defense	74.7	85.2	85.6
Nondefense	29.5	31.0	31.1
Subtotal, direct major public physical capital investment	104.2	116.3	116.7
Grants to State and local governments	59.8	61.3	63.1
Subtotal, major public physical capital investment	164.1	177.6	179.8
Conduct of research and development:			
National defense	57.3	65.8	71.4
Nondefense	44.1	49.2	52.6
Subtotal, conduct of research and development	101.4	115.0	124.0
Conduct of education and training:			
Grants to State and local governments	45.2	50.6	51.4
Direct Federal	34.5	33.6	34.8
Subtotal, conduct of education and training	79.7	84.2	86.2
Total, major Federal investment outlays	**345.2**	**376.7**	**390.0**
MEMORANDUM			
Major Federal investment outlays:			
National defense	132.0	151.0	157.0
Nondefense	213.1	225.7	233.0
Total, major Federal investment outlays	345.2	376.7	390.0
Miscellaneous physical investment:			
Commodity inventories	–0.6	–1.1	–0.4
Other physical investment (direct)	5.7	4.2	3.7
Total, miscellaneous physical investment	5.1	3.1	3.3
Total, Federal investment outlays, including miscellaneous physical investment	350.3	379.8	393.3

to be $34.8 billion in 2005. Programs in this category are primarily aid for higher education through student financial assistance, loan subsidies, the veterans GI bill, and health training programs.

This category does not include outlays for education and training of Federal civilian and military employees. Outlays for education and training that are for physical investment and for research and development are in the categories for physical investment and the conduct of research and development.

Miscellaneous Physical Investment Outlays

In addition to the categories of major Federal investment, several miscellaneous categories of investment outlays are shown at the bottom of Table 6–1. These items, all for physical investment, are generally unrelated to improving Government operations or enhancing economic activity.

Outlays for commodity inventories are primarily for the purchase or sale of agricultural products pursuant to farm price support programs. Sales are estimated to exceed purchases by $0.4 billion in 2005.

Outlays for other miscellaneous physical investment are estimated to be $3.7 billion in 2005. This category includes primarily conservation programs. These are entirely direct Federal outlays.

Detailed Table on Investment Spending

The following table provides data on budget authority as well as outlays for major Federal investment divided according to grants to State and local governments and direct Federal spending. Miscellaneous investment is not included because it is generally unrelated to improving Government operations or enhancing economic activity.

Table 6–2. FEDERAL INVESTMENT BUDGET AUTHORITY AND OUTLAYS: GRANT AND DIRECT FEDERAL PROGRAMS

(in millions of dollars)

Description	Budget Authority			Outlays		
	2003 Actual	2004 Estimate	2005 Estimate	2003 Actual	2004 Estimate	2005 Estimate
GRANTS TO STATE AND LOCAL GOVERNMENTS						
Major public physical investments:						
Construction and rehabilitation:						
Transportation:						
Highways	29,518	33,763	33,517	30,379	31,089	32,710
Mass transportation	10,629	6,939	7,017	7,336	8,228	7,666
Air transportation	3,379	3,381	3,501	2,681	3,395	3,471
Subtotal, transportation	43,526	44,083	44,035	40,396	42,712	43,847
Other construction and rehabilitation:						
Pollution control and abatement	2,499	2,511	2,348	2,883	1,037	2,359
Community development block grants	4,905	4,934	4,618	5,569	5,990	5,586
Other community and regional development	1,481	1,203	901	1,379	1,532	1,456
Housing assistance	7,250	6,845	6,711	7,827	8,133	8,384
Other construction	255	402	139	715	704	204
Subtotal, other construction and rehabilitation	16,390	15,895	14,717	18,373	17,396	17,989
Subtotal, construction and rehabilitation	59,916	59,978	58,752	58,769	60,108	61,836
Other physical assets	1,247	1,265	1,189	1,074	1,195	1,290
Subtotal, major public physical capital	61,163	61,243	59,941	59,843	61,303	63,126
Conduct of research and development:						
Agriculture	254	264	283	251	260	261
Other	553	574	830	319	495	870
Subtotal, conduct of research and development	807	838	1,113	570	755	1,131
Conduct of education and training:						
Elementary, secondary, and vocational education	34,392	36,527	37,971	29,004	34,903	35,967
Higher education	458	461	395	487	594	487
Research and general education aids	696	742	693	782	819	683
Training and employment	3,531	3,350	4,337	4,603	3,837	3,625
Social services	9,775	9,929	10,145	9,607	9,726	9,946
Agriculture	455	439	420	423	436	421
Other	911	269	249	282	236	267
Subtotal, conduct of education and training	50,218	51,717	54,210	45,188	50,551	51,396
Subtotal, grants for investment	112,188	113,798	115,264	105,601	112,609	115,653
DIRECT FEDERAL PROGRAMS						
Major public physical investment:						
Construction and rehabilitation:						
National defense:						
Military construction and family housing	7,283	6,357	6,416	5,917	6,560	6,451
Atomic energy defense activities and other	835	883	489	795	834	714
Subtotal, national defense	8,118	7,240	6,905	6,712	7,394	7,165
Nondefense:						
International affairs	1,101	1,098	1,100	656	1,000	987
General science, space, and technology	2,318	2,065	2,418	2,436	2,137	2,287
Water resources projects	3,035	2,906	2,330	3,104	2,583	2,654
Other natural resources and environment	1,728	2,106	1,756	1,905	1,662	2,030
Energy	1,685	1,598	1,586	1,685	1,600	1,580
Postal Service	442	637	714	307	409	530
Transportation	345	426	546	342	389	564
Veterans hospitals and other health facilities	2,542	1,646	1,791	2,187	1,675	1,581
Federal Prison System	263	178	....	533	275	390
GSA real property activities	1,720	1,748	1,636	1,298	1,926	1,872
Other construction	3,297	2,349	1,765	2,919	2,582	1,905
Subtotal, nondefense	18,476	16,757	15,642	17,372	16,238	16,380
Subtotal, construction and rehabilitation	26,594	23,997	22,547	24,084	23,632	23,545

Table 6–2. FEDERAL INVESTMENT BUDGET AUTHORITY AND OUTLAYS: GRANT AND DIRECT FEDERAL PROGRAMS—Continued

(in millions of dollars)

Description	Budget Authority			Outlays		
	2003 Actual	2004 Estimate	2005 Estimate	2003 Actual	2004 Estimate	2005 Estimate
Acquisition of major equipment:						
National defense:						
Department of Defense	78,484	80,918	74,986	67,890	77,705	78,246
Atomic energy defense activities	128	202	142	128	157	182
Subtotal, national defense	78,612	81,120	75,128	68,018	77,862	78,428
Nondefense:						
General science and basic research	545	562	608	463	601	568
Space flight, research, and supporting activities	485	670	681	411	544	667
Postal Service	803	1,267	730	470	602	927
Air transportation	3,654	2,879	3,536	2,763	3,970	3,725
Water transportation (Coast Guard)	433	557	571	436	433	483
Other transportation (railroads)	1,043	1,218	900	1,001	1,334	900
Hospital and medical care for veterans	1,034	1,019	1,020	1,949	1,936	1,936
Law enforcement activities	1,488	1,890	1,829	1,187	1,832	1,876
Department of the Treasury (fiscal operations)	492	591	498	547	577	576
Department of Commerce (NOAA)	779	773	852	681	645	768
GSA general supply fund	676	750	724	626	750	724
Other	856	749	930	935	936	998
Subtotal, nondefense	12,288	12,925	12,879	11,469	14,160	14,148
Subtotal, acquisition of major equipment	90,900	94,045	88,007	79,487	92,022	92,576
Purchase or sale of land and structures:						
National defense	–23	–33	–33	–23	–33	–33
Natural resources and environment	434	296	223	458	343	296
General government	179	170	161	200	265	214
Other	28	42	117	16	32	89
Subtotal, purchase or sale of land and structures	618	475	468	651	607	566
Subtotal, major public physical investment	118,112	118,517	111,022	104,222	116,261	116,687
Conduct of research and development:						
National defense:						
Defense military	58,793	65,432	69,791	53,778	61,347	67,041
Atomic energy and other	3,836	3,968	4,315	3,550	4,449	4,363
Subtotal, national defense	62,629	69,400	74,106	57,328	65,796	71,404
Nondefense:						
International affairs	269	269	255	229	260	258
General science, space and technology						
NASA	7,369	7,596	7,774	6,002	7,148	7,921
National Science Foundation	3,640	3,762	3,862	3,235	3,473	3,727
Department of Energy	2,509	2,712	2,624	2,480	2,718	2,624
Subtotal, general science, space and technology	13,787	14,339	14,515	11,946	13,599	14,530
Energy	1,275	1,435	1,468	1,325	1,504	1,621
Transportation:						
Department of Transportation	547	531	566	483	546	599
NASA	999	1,034	919	1,663	1,026	1,000
Other	181	181	229	49	293	228
Subtotal, transportation	3,002	3,181	3,182	3,520	3,369	3,448
Health:						
National Institutes of Health	25,178	27,021	27,681	21,835	24,559	26,698
All other health	725	652	719	927	652	688
Subtotal, health	25,903	27,673	28,400	22,762	25,211	27,386

Table 6–2. FEDERAL INVESTMENT BUDGET AUTHORITY AND OUTLAYS: GRANT AND DIRECT FEDERAL PROGRAMS—Continued

(in millions of dollars)

Description	Budget Authority			Outlays		
	2003 Actual	2004 Estimate	2005 Estimate	2003 Actual	2004 Estimate	2005 Estimate
Agriculture	1,432	1,538	1,216	1,377	1,391	1,306
Natural resources and environment	2,018	2,049	2,040	1,839	1,791	1,953
National Institute of Standards and Technology	421	410	326	433	449	488
Hospital and medical care for veterans	817	822	770	783	812	770
All other research and development	1,097	1,346	1,329	882	1,833	1,575
Subtotal, nondefense	48,477	51,358	51,778	43,542	48,455	51,456
Subtotal, conduct of research and development	111,106	120,758	125,884	100,870	114,251	122,860
Conduct of education and training:						
Elementary, secondary, and vocational education	1,902	1,648	1,341	1,858	2,063	1,754
Higher education	23,872	22,105	23,260	23,875	21,642	23,118
Research and general education aids	1,789	1,856	1,882	1,699	1,838	1,887
Training and employment	1,563	1,576	1,661	1,514	1,528	1,611
Health	1,634	1,575	1,297	1,500	1,704	1,568
Veterans education, training, and rehabilitation	2,227	2,479	2,502	2,295	2,633	2,795
General science and basic research	935	930	864	775	953	901
National defense	8	8	8	9	8	8
International affairs	405	349	376	393	352	373
Other	619	763	643	567	886	774
Subtotal, conduct of education and training	34,954	33,289	33,834	34,485	33,607	34,789
Subtotal, direct Federal investment	264,172	272,564	270,740	239,577	264,119	274,336
Total, Federal investment	376,360	386,362	386,004	345,178	376,728	389,989

PART II: PERFORMANCE OF FEDERAL INVESTMENT

Introduction. In recent years there has been increased emphasis on the performance of Government programs. The Congress mandated in the Government Performance and Results Act of 1993 that performance plans be developed and that the agencies report annual progress against these plans.

In addition, this Administration began in the *2004 Budget* to assess every Federal program over a five year period by a method known as the Program Assessment Rating Tool, or PART. With this budget, the second year of using the PART, the Administration has assessed about two-fifths of the programs of the Federal Government The PART system assesses each program on four components (purpose, planning, management, and results/accountability) and gives a score for each of the components. The scores for each component are then weighted—results/accountability carries the greatest weight—and the program is given an overall score. A program is rated effective if it receives an overall score of 85 percent or more, moderately effective if the score is 70 to 85 percent, adequate if the score is 50 to 70 percent, and inadequate if the score is 49 percent or lower. The program is given a rating "Results Not Demonstrated" if the program does not have a good performance measure or does not have data for that measure. Chapter 2 of this volume discusses the PART concepts in more detail.

This section summarizes the results of the PART for direct investment programs, defined to include capital assets, research and development, and education. Because an entire program is assessed, not just the investment portion of the program, the assessments for some programs may cover more than just the investment spending. PART assessments of programs that are grants to State and local governments are not summarized in this chapter but are summarized in Chapter 8, "Aid to State and Local Governments", in this volume.

This section covers the following 119 programs.

- Programs for capital assets are those identified in the PART system as "capital assets and service acquisition" (44 programs);
- Programs for research and development are essentially those identified in the PART system as "research and development" (59 programs); and
- Programs for education (16 programs) are primarily programs in the Department of Education that are not grants to State and local governments (e.g., Federal Pell grants to individuals). This category also includes a few education programs in other agencies, such as the Montgomery GI Bill in the Department of Veterans Affairs and the Health Professions program in the Department of Health and Human Services.

Information on these and other programs assessed by PART is on the CD ROM that accompanies this volume.

Summary of ratings. Table 6–3 shows that the average weighted score for the 119 investment programs that have been rated by PART was 66 percent, which is a rating of "adequate". These programs had total spending of $132.0 billion in 2003. Of these programs:

- 39 were rated "results not demonstrated" ($42.1 billion);
- 23 were rated effective ($8.8 billion);
- 31 were rated moderately effective ($34.6 billion);
- 19 were rated adequate ($39.4 billion); and
- 7 were rated ineffective ($7.1 billion).

Table 6–3. SUMMARY OF PART RATINGS AND SCORES FOR DIRECT FEDERAL INVESTMENT PROGRAMS

(excludes grants to State and local governments for investment)

Criteria	Type of Investment			
	Physical capital	Research and development	Education and training	All investment programs
	Average Scores			
Purpose	80%	91%	76%	85%
Planning	74%	76%	74%	75%
Management	81%	84%	64%	80%
Results/Accountability	49%	58%	35%	51%
Weighted Average[1]	64%	71%	53%	66%
Average Rating	Adequate	Moderately effective	Adequate	Adequate
	Number of Programs			
Ratings[2]				
Results not demonstrated	19	15	5	39
Effective	6	16	1	23
Moderately effective	10	20	1	31
Adequate	7	6	6	19
Ineffective	2	2	3	7
Total number of investment programs rated	44	59	16	119
	In millions of dollars (2003)			
Results not demonstrated	$36,114	$2,842	$3,116	$42,072
Effective	1,005	7,736	49	8,790
Moderately effective	29,140	5,337	171	34,648
Adequate	19,500	570	19,361	39,431
Ineffective	6,215	89	779	7,083
All investment programs that were rated in PART	$91,974	$16,574	$23,476	$132,024

[1] Weighted as follows: Purpose (20%), Planning (10%), Management (20%), Results/Accountability (50%).

[2] The rating of effective indicates a score of 85 percent or more; moderately effective, 70–85 percent; adequate, 50–70 percent; and ineffective, 49 percent or less.

Assessments of individual programs. The ratings of the ten physical capital and education and training investment programs with the largest funding are summarized here. Information on research and development is in Chapter 5, "Research and Development" in this volume.

Capital Assets

Department of Defense. Air Combat Program ($15.1 billion in 2003). Rating: *Moderately Effective.* This program consists of a number of individual aircraft and helicopter research, development and procurement programs that, taken together, comprise DOD's investment in air combat capabilities. The PART analysis showed that the program purpose is clear owing to the unique military requirement for these systems.

Department of Defense. Shipbuilding ($9.5 billion). Rating: *Adequate.* This program buys new ships and overhauls older ships for the Navy. The assessment shows that the program has a clear purpose, and the Navy has specific cost, schedule, and performance goals for each shipbuilding program. The program has experienced cost increases and schedule slips on some ship construction programs.

Tennessee Valley Authority (TVA) ($7.6 billion in 2003). Rating: *Moderately Effective.* TVA is the fifth largest electric utility in the country, generating power at 48 coal-fired, hydropower, nuclear, and other power plants that it operates to meet the electricity needs of 8.3 million people (3 percent of the U. S. market). The PART assessment gave TVA mixed reviews. TVA does an excellent job generating power at its existing power plants. A decade ago TVA's nuclear power plants posed serious technical and safety problems but it has overcome these problems and today its nuclear power plants set industry standards.

However, TVA has a high level of debt compared to many of its competitors in the electricity industry. It has recently issued a strategic plan that includes a debt reduction target of $3 billion to $5 billion over the next 10 to 12 years, which is incorporated into the budget estimates for TVA and will be a basis on which TVA's annual performance plans are developed.

Department of Defense. Missile Defense ($7.5 billion in 2003). Rating: *Results Not Demonstrated.* This program consists of multiple systems and capabilities developed by the Missile Defense Agency (MDA) or military services. This program fields active defenses against short, medium, and long-range missiles in a multi-layered global system.

The assessment found that: a) the Department of Defense continues to design, engineer, and develop extensive missile defense capabilities, but has not programmed adequate funds to procure and operate newly developed capabilities; b) technical progress continues, but there have been challenges. Some missiles have operated effectively, but also experienced command and control problems; some tests have failed, but some were a success.

Department of Energy. Environmental Management ($7.6 billion in 2003). Rating: *Adequate.* This program protects human health and the environment by cleaning up waste and contamination resulting from more than 50 years of nuclear weapons production and energy research at 114 Department of Energy sites in the United States and its territories. The assessment found that managers are implementing reforms that are improving program performance. The program needs to develop annual cost and schedule performance measures.

General Services Administration. GSA's Regional IT Solutions Program ($5.8 billion in 2003). Rating: *Results Not Demonstrated.* This program provides expert technical, acquisition, and information technology products and services to Federal clients. This assessment found that the program is useful to Federal agencies that do not have in-house expertise to acquire IT products or services. The assessment also found that the program does not have long-term outcome goals that relate to other government agencies or the private sector.

Department of Defense. Communications Infrastructure ($5.6 billion in 2003). Rating: *Results Not Demonstrated.* This program includes all networks and systems for transmission of voice, data, and video information for the Department. This assessment revealed that DOD does not manage its communications infrastructure on an enterprise or department-wide basis. The assessment also suggested that DOD should develop common performance measures to be used across the entire department for this program.

Department of Defense. Airlift Program ($5.3 billion in 2003). Rating: *Moderately Effective.* This program consists of a number of individual Air Force tactical and strategic airlift aircraft research, development and procurement programs that, taken together, comprise DOD's investment in airlift capabilities. The analysis showed that this is a coherent program with a clear and basic long-term goal, namely to be able to move military forces and their equipment from the U.S. to anywhere in the world whenever required. DOD must aggressively examine possible trade-offs within the program that could lower the cost of meeting the airlift requirement without sacrificing military readiness or combat capabilities.

Department of Housing and Urban Development. Project-Based Rental Assistance ($4.8 billion in 2003). Rating: *Ineffective.* This program provides funding to landlords who rent a certain number of affordable apartments to low-income families or individuals. Assistance is tied directly to the properties—tenants cannot move without losing their assistance. The program receives low performance scores in part because there is confusion over program objectives, the program lacks strong financial accountability, and it produces poor results relative to alternative forms of housing assistance.

Education

Department of Education. Federal Pell Grants ($11.4 billion in 2003). Rating: *Adequate.* This program provides grant aid to nearly five million needy students to help them pay for an undergraduate education. The assessment found that the program helps ensure that low-income students can afford a college education. However, the Department of Education has only been minimally successful in achieving its long-term and annual performance goals for its main student aid programs. In addition, Pell grants, like other student aid, are prone to abuse, where students who under-report family income receive more aid than they should. The Department estimates that net overawards in Pell total more than $350 million annually.

PART III: FEDERALLY FINANCED CAPITAL STOCKS

Federal investment spending creates a "stock" of capital that is available in the future for productive use. Each year, Federal investment outlays add to this stock of capital. At the same time, however, wear and tear and obsolescence reduce it. This section presents very rough measures over time of three different kinds of capital stocks financed by the Federal Government: public physical capital, research and development (R&D), and education.

Federal spending for physical assets adds to the Nation's capital stock of tangible assets, such as roads, buildings, and aircraft carriers. These assets deliver a flow of services over their lifetime. The capital depreciates as the asset ages, wears out, is accidentally damaged, or becomes obsolete.

Federal spending for the conduct of research and development adds to an "intangible" asset, the Nation's stock of knowledge. Spending for education adds to the stock of human capital by providing skills that help make people more productive. Although financed by the Federal Government, the research and development or education can be carried out by Federal or State government laboratories, universities and other nonprofit organizations, local governments, or private industry. Research and development covers a wide range of activities, from the investigation of subatomic particles to the exploration of outer space; it can be "basic" research without particular applications in mind, or it can have a highly specific practical use. Similarly, education includes a wide variety of programs, assisting people of all ages beginning with pre-school education and extending through graduate studies and adult education. Like physical assets, the capital stocks of R&D and education provide services over a number of years and depreciate as they become outdated.

For this analysis, physical and R&D capital stocks are estimated using the perpetual inventory method. Each year's Federal outlays are treated as gross investment, adding to the capital stock; depreciation reduces the capital stock. Gross investment less depreciation is net investment. The estimates of the capital stock are equal to the sum of net investment in the current and prior years. A limitation of the perpetual inventory method is that the original investment spending may not accurately measure the current value of the asset created, even after adjusting for inflation, because the value of existing capital changes over time due to changing market conditions. However, alternative methods for measuring asset value, such as direct surveys of current market worth or indirect estimation based on an expected rate of return, are especially difficult to apply to assets that do not have a private market, such as highways or weapons systems.

In contrast to physical and R&D stocks, the estimate of the education stock is based on the replacement cost method. Data on the total years of education of the U.S. population are combined with data on the current cost of education and the Federal share of education spending to yield the cost of replacing the Federal share of the Nation's stock of education.

It should be stressed that these estimates are rough approximations, and provide a basis only for making broad generalizations. Errors may arise from uncertainty about the useful lives and depreciation rates of different types of assets, incomplete data for historical outlays, and imprecision in the deflators used to express costs in constant dollars. The methods used to estimate capital stocks are discussed further in the technical note at the end of Chapter 12, "Stewardship," in this volume. Additional detail about these methods appeared in a methodological note in the Chapter 7, "Federal Investment Spending and Capital Budgeting," in the *Analytical Perspectives* volume of the *2004 Budget.*

The Stock of Physical Capital

This section presents data on stocks of physical capital assets and estimates of the depreciation of these assets.

Trends.—Table 6–4 shows the value of the net federally financed physical capital stock since 1960, in constant fiscal year 2000 dollars.[1] The total stock grew at a 2.2 percent average annual rate from 1960 to 2003, with periods of faster growth during the late 1960s and the 1980s. The stock amounted to $2,137 billion in 2003 and is estimated to increase to $2,266 billion by 2005. In 2003, the national defense capital stock accounted for $646 billion, or 30 percent of the total, and nondefense stocks for $1,491 billion, or 70 percent of the total.

[1] Constant dollar stock estimates are expressed in chained 2000 dollars, consistent with the December 2003 revisions to the National Income and Product Accounts. The shift to a more recent base year changes the reported level of real stocks, but leaves the year-to-year trends largely the same.

Table 6–4. NET STOCK OF FEDERALLY FINANCED PHYSICAL CAPITAL

(In billions of 2000 dollars)

Fiscal Year	Total	National Defense	Nondefense								
			Total Non-defense	Direct Federal Capital			Capital Financed by Federal Grants				
				Total	Water and Power	Other	Total	Trans-portation	Commu-nity and Regional	Natural Resources	Other
Five year intervals:											
1960	849	608	242	95	59	36	146	89	27	21	10
1965	937	589	348	123	74	49	225	158	32	22	13
1970	1,101	630	470	146	88	58	324	230	47	26	21
1975	1,137	545	592	166	102	64	426	282	76	42	25
1980	1,258	494	763	195	123	72	568	342	121	79	27
1985	1,462	572	890	222	136	86	668	397	146	100	26
1990	1,740	722	1,018	256	147	109	762	462	158	113	28
1995	1,882	714	1,168	297	157	141	871	534	168	123	46
Annual data:											
2000	1,979	635	1,345	337	160	178	1,007	618	183	131	75
2001	2,022	631	1,391	351	163	188	1,040	640	186	132	81
2002	2,078	636	1,442	366	165	201	1,076	666	189	134	87
2003	2,137	646	1,491	379	166	213	1,112	690	193	135	94
2004 est.	2,204	663	1,541	393	167	226	1,148	716	196	135	100
2005 est.	2,266	677	1,588	405	168	237	1,183	741	199	136	106

Real stocks of defense and nondefense capital show very different trends. Nondefense stocks have grown consistently since 1970, increasing from $470 billion in 1970 to $1,491 billion in 2003. With the investments proposed in the budget, nondefense stocks are estimated to grow to $1,588 billion in 2005. During the 1970s, the nondefense capital stock grew at an average annual rate of 5.0 percent. In the 1980s, however, the growth rate slowed to 2.9 percent annually, with growth continuing at about that rate since then.

Real national defense stocks began in 1970 at a relatively high level, and declined steadily throughout the decade as depreciation from investment in the Vietnam era exceeded new investment in military construction and weapons procurement. Starting in the early 1980s, a large defense buildup began to increase the stock of defense capital. By 1987, the defense stock exceeded its earlier Vietnam-era peak. In the early 1990s, however, depreciation on the increased stocks and a slower pace of defense physical capital investment began to reduce the stock from its previous levels. The increased defense investment in the last few years has reversed this decline, increasing the stock from an estimated $646 billion in 2003 to $677 billion in 2005.

Another trend in the Federal physical capital stocks is the shift from direct Federal assets to grant-financed assets. In 1960, 39 percent of federally financed nondefense capital was owned by the Federal Government, and 61 percent was owned by State and local governments but financed by Federal grants. Expansion in Federal grants for highways and other State and local capital, coupled with slower growth in direct Federal investment for water resources, for example, shifted the composition of the stock substantially. In 2003, 25 percent of the nondefense stock was owned by the Federal Government and 75 percent by State and local governments.

The growth in the stock of physical capital financed by grants has come in several areas. The growth in the stock for transportation is largely grants for highways, including the Interstate Highway System. The growth in community and regional development stocks occurred largely following the enactment of the community development block grant in the early 1970s. The value of this capital stock has grown only slowly in the past few years. The growth in the natural resources area occurred primarily because of construction grants for sewage treatment facilities. The value of this federally financed stock has increased about 35 percent since the mid-1980s.

The Stock of Research and Development Capital

This section presents data on the stock of research and development capital, taking into account adjustments for its depreciation.

Trends.—As shown in Table 6–5, the R&D capital stock financed by Federal outlays is estimated to be $1,054 billion in 2003 in constant 2000 dollars. Roughly half is the stock of basic research knowledge; the remainder is the stock of applied research and development.

The nondefense stock accounted for about three-fifths of the total federally financed R&D stock in 2003. Although investment in defense R&D has exceeded that of nondefense R&D in nearly every year since 1981, the nondefense R&D stock is actually the larger of the two, because of the different emphasis on basic research and applied research and development. Defense R&D spending is heavily concentrated in applied research and development, which depreciates much more quickly than basic research. The stock of applied research and development is assumed to depreciate at a ten percent geometric rate, while basic research is assumed not to depreciate at all.

The defense R&D stock rose slowly during the 1970s, as gross outlays for R&D trended down in constant dollars and the stock created in the 1960s depreciated. Increased defense R&D spending from 1980 through 1990 led to a more rapid growth of the R&D stock. Subsequently, real defense R&D outlays tapered off, depreciation grew, and, as a result, the real net defense R&D stock stabilized at around $420 billion. Renewed spending for defense R&D in this budget is projected to increase the stock to $513 billion in 2005.

The growth of the nondefense R&D stock slowed from the 1970s to the 1980s, from an annual rate of 3.8 percent in the 1970s to a rate of 2.1 percent in the 1980s. Gross investment in real terms fell during much of the 1980s, and about three-fourths of new outlays went to replacing depreciated R&D. Since 1988, however, nondefense R&D outlays have been on an upward trend while depreciation has edged down. As a result, the net nondefense R&D capital stock has grown more rapidly.

Table 6–5. NET STOCK OF FEDERALLY FINANCED RESEARCH AND DEVELOPMENT[1]

(In billions of 2000 dollars)

Fiscal Year	National Defense			Nondefense			Total Federal		
	Total	Basic Research	Applied Research and Development	Total	Basic Research	Applied Research and Development	Total	Basic Research	Applied Research and Development
Five year intervals:									
1970	261	16	245	215	67	148	475	82	393
1975	276	21	256	262	97	165	538	118	421
1980	279	25	255	311	131	179	590	156	434
1985	321	30	291	339	174	165	659	204	455
1990	403	36	367	382	229	154	785	265	520
1995	418	40	378	428	268	161	846	308	539
Annual data:									
2000	423	48	375	543	368	175	966	416	549
2001	421	50	371	563	386	177	984	436	548
2002	435	52	383	579	405	175	1,014	457	557
2003	456	54	402	598	424	174	1,054	478	577
2004 est.	483	55	428	621	445	176	1,104	501	604
2005 est.	513	57	456	646	467	178	1,159	524	634

[1] Excludes stock of physical capital for research and development, which is included in Table 6–4.

The Stock of Education Capital

This section presents estimates of the stock of education capital financed by the Federal Government.

As shown in Table 6–6, the federally financed education stock is estimated at $1,292 billion in 2003 in constant 2000 dollars. The vast majority of the Nation's education stock is financed by State and local governments, and by students and their families themselves. This federally financed portion of the stock represents about 3 percent of the Nation's total education stock.[2] Nearly three-quarters is for elementary and secondary education, while the remaining one quarter is for higher education.

The federally financed education stock has grown steadily in the last few decades, with an average annual growth rate of 5.4 percent from 1970 to 2003. The expansion of the education stock is projected to continue under this budget, with the stock rising to $1,465 billion in 2005.

[2] For estimates of the total education stock, see table 12–4 in Chapter 12, "Stewardship."

Table 6–6. NET STOCK OF FEDERALLY FINANCED EDUCATION CAPITAL

(In billions of 2000 dollars)

Fiscal Year	Total Education Stock	Elementary and Secondary Education	Higher Education
Five year intervals:			
1960	70	51	20
1965	98	71	27
1970	225	176	49
1975	324	260	64
1980	458	356	102
1985	565	421	144
1990	745	550	195
1995	853	619	234
Annual data:			
2000	1,121	819	302
2001	1,174	847	327
2002	1,221	879	342
2003	1,292	932	360
2004 est.	1,378	1,004	374
2005 est.	1,465	1,073	391

7. CREDIT AND INSURANCE

Federal credit programs offer direct loans and loan guarantees for a wide range of activities, primarily housing, education, business and community development, and exports. At the end of 2003, there were $249 billion in Federal direct loans outstanding and $1,184 billion in loan guarantees. Through its insurance programs, the Federal Government insures bank, thrift, and credit union deposits, guarantees private defined-benefit pensions, and insures against other risks such as natural disasters, all up to certain limits.

The Federal Government also enhances credit availability for targeted sectors indirectly through Government-Sponsored Enterprises (GSEs)—privately owned companies and cooperatives that operate under Federal charters. GSEs increase liquidity by guaranteeing and securitizing loans, as well as by providing direct loans. In return for serving social purposes, GSEs enjoy many privileges, which differ across GSEs. In general, GSEs can borrow from Treasury in amounts ranging up to $4 billion at Treasury's discretion, GSEs' corporate earnings are exempt from state and local income taxation, GSE securities are exempt from SEC registration, and banks and thrifts are allowed to hold GSE securities in unlimited amounts and use them to collateralize public deposits. These privileges leave many people with the impression that their securities are risk-free. GSEs, however, are not part of the Federal Government, and their securities are not federally guaranteed. By law, GSE securities carry a disclaimer of any U.S. obligation.

This chapter discusses the roles and risks of these diverse programs and entities in the context of evolving financial markets and assesses their effectiveness and efficiency.

- The first section analyzes the roles of Federal credit and insurance programs. Federal programs play useful roles when market imperfections prevent the private market from efficiently providing credit and insurance. Financial evolution has partly corrected many imperfections and generally weakened the justification for Federal intervention. The roles of Federal programs, however, may still be critical in some areas.
- The second section examines how credit and insurance programs fared with the Program Assessment Rating Tool (PART) and discusses special features of credit programs that may need to be considered in interpreting and refining this tool.
- The third section reviews Federal credit programs and GSEs in four sectors: housing, education, business and community development, and exports. This section discusses program objectives, recent developments, performance, and future plans for each program.
- The final section describes Federal deposit insurance, pension guarantees, disaster insurance, and insurance against terrorism and other security-related risks in a context similar to that for credit programs.

I. FEDERAL PROGRAMS IN CHANGING FINANCIAL MARKETS

The Federal Role

The roles of Federal credit and insurance programs can be broadly classified into two categories: helping disadvantaged groups and correcting market imperfections. Subsidized Federal credit programs redistribute resources from the general taxpayer to disadvantaged regions or segments of the population. Since disadvantaged groups can be assisted through other means, such as direct subsidies, the value of a credit or insurance program critically depends on the extent to which it corrects market imperfections.

In most cases, private lending and insurance businesses efficiently meet societal demands by allocating resources to the most productive uses, and Federal intervention is unnecessary or can even be distortionary. However, Federal intervention may improve the market outcome in some situations.

Insufficient Information. Financial intermediaries promote economic growth by allocating credit to the most productive uses. This critical function, however, may not be performed effectively when there is little objective information about borrowers. Some groups of borrowers, such as start-up businesses, start-up farmers, and students, have limited incomes and credit histories. Many creditworthy borrowers belonging to these groups may fail to obtain credit or be forced to pay excessively high interest. Government intervention, such as loan guarantees, can reduce this inefficiency by enabling these borrowers to obtain credit more easily and cheaply and also by providing opportunities for lenders to learn more about those borrowers.

Externalities. Decisions at the individual level are not socially optimal when individuals do not capture the full benefit (positive externalities) or bear the full cost (negative externalities) of their activities. Examples of positive and negative externalities are education and pollution. The general public benefits from the high productivity and good citizenship of a well-educated person and suffers from pollution. Without Government intervention, people will engage less than socially optimal in activities that generate positive externalities and more in activities that generate negative externalities. Federal programs can address externalities by influencing individuals' incentives.

Limited Ability to Secure Resources. The ability of private entities to absorb losses is more limited than that of the Federal Government, which has general taxing authority. For some events potentially involving a very large loss concentrated in a short time period, therefore, Government insurance commanding more resources can be more credible and effective. Such events include massive bank failures and some natural and man-made disasters that can threaten the solvency of private insurers. Resource constraints can also limit the lending ability of private entities. Small lenders operating in a local market, in particular, may have limited access to capital and occasionally be forced to pass up good lending opportunities.

Imperfect competition. Competition is imperfect in some markets because of barriers to entry, economies of scale, and foreign government intervention. For example, legal barriers to entry or geographic isolation can cause imperfect competition in some rural areas. If the lack of competition forces some rural residents to pay excessively high interest on loans, Government credit programs aiming to increase the availability of credit and lower the borrowing cost for those rural residents may improve economic efficiency.

Effects of Changing Financial Markets

Financial markets have undergone fundamental changes that greatly enhanced competition and economic efficiency. The main forces behind these changes are financial services deregulation and technological advances. Deregulation, represented by the Riegle-Neal Interstate Banking and Branching Act of 1997 and the Financial Services Modernization Act of 1999, has increased competition and prompted consolidation by removing geographic and industry barriers. By increasing the availability of information and lowering transaction costs, technological advances have significantly contributed to enhancing liquidity, refining risk management tools, and spurring globalization. These developments have significant implications for Federal credit and insurance programs.

Financial evolution has generally increased the private market's capacity to serve the populations traditionally targeted by Federal programs, and hence has weakened the role of Federal credit and insurance programs. The private market now has more information and better technology to process it, has better means to secure resources, and is more competitive. To improve the effectiveness of credit and insurance programs, therefore, the Federal Government may focus on more specific objectives that have been less affected by financial evolution and on narrower target populations that still have difficulty in obtaining credit from private lenders. Problems related to externalities, for example, are likely to persist because the price mechanisms that drive the private market will continue to ignore the value of the externality. In addition, the benefits of deregulation and technological advances may have been uneven across populations. The Federal Government also needs to pay more attention to new challenges introduced by financial evolution and other economic developments.

Information about borrowers is more widely available and easier to process, thanks to technological advances. Lenders now have easy access to large databases, powerful computers, and sophisticated analytical models. Thus, many lenders use credit scoring models that evaluate creditworthiness based on various borrower characteristics derived from extensive credit bureau data. As a result, creditworthy borrowers are less likely to be turned down, while borrowers that are not creditworthy are less likely to be approved for credit. The Federal role of improving credit allocation, therefore, is generally not as strong as it once was. The benefit from financial evolution, however, can be uneven across groups and over time. Credit scoring, for example, is still difficult to apply to some borrowers with unique characteristics that are difficult to standardize. In times of economic downturn or financial instability, lenders can be overly cautious, turning away some creditworthy borrowers.

Financial evolution has also alleviated resource constraints faced by private entities. Financial derivatives, such as options, swaps, and futures, have improved the market's ability to manage and share various types of risk such as price risk, interest rate risk, credit risk, and even catastrophe-related risk. An insurer can distribute the risk of a natural or man-made catastrophe among a large number of investors through catastrophe-related derivatives, although the extent of risk sharing in this way is still limited because of the small size of the market for those products. Securitization (pooling a certain type of asset and selling shares of the asset pool to investors) facilitates fund raising and risk management. By securitizing loans, even a lender with limited access to capital can make a large amount of loans, while limiting its exposure to credit and interest risk.

Imperfect competition is much less likely in general. Financial deregulation removed legal barriers to competition. More commercial firms borrow directly in capital markets, bypassing financial intermediaries; the use of commercial paper (short-term financing instruments issued by corporations) has been particularly notable. Nonbank financial institutions, such as finance companies and venture capital firms, have increased their presence, providing more financing alternatives to small, start-up firms that formerly relied heavily on banks. Internet-based financial services have lowered the cost of financial transactions and reduced the importance of physical location. Due to globalization, foreign financial institutions actively compete in the U.S. market. All of these developments have increased competition.

Nevertheless, concerns remain. The removal of geographic barriers spurred consolidation among banks.

Consolidation can negatively affect the markets that were traditionally served by small banks. Large financial institutions with global operations may want to focus more on large customers and business lines that utilize economies of scale and scope more fully, leaving out small borrowers in remote rural areas and inner city areas. Another concern is that nontraditional financing sources, such as commercial paper and venture capital, can become unavailable when they are needed most. For example, commercial-paper issuance by nonfinancial companies and venture capital investments plunged during the last recession. The decreased volume of these instruments may have mostly reflected changed market conditions, such as decreased investment demand. A part of the reason, however, may have been the investors' overreaction to unfavorable market conditions, which could cause financing difficulties for creditworthy firms. Federal credit programs can play useful roles on these occasions.

Overall, the financial market is evolving to be more efficient and safer. Financial evolution and other economic developments, however, are often accompanied by new risks. Federal agencies need to be vigilant to identify and, when appropriate, to manage new risks. Consolidation, for example, has increased bank size. Thus, the failure of even a single large bank can seriously drain the federal deposit insurance fund. As a result of deregulation, banks engage in more activities. While diversification across business lines may generally improve the safety of banks, new businesses introduce new risks. For example, one concern raised recently is that the motive to obtain underwriting business from borrowing firms may have affected lending decisions, undermining loan quality at some large banking organizations. Globalization also has both an upside and a downside. A financial institution with a worldwide operation may overcome difficulties in the U.S. market more easily, but it is more heavily exposed to economic turmoil in other countries, especially those that are less-developed or politically unstable. The large size of some GSEs is also a potential problem. Financial trouble of a large GSE could cause repercussions in financial markets, affecting federally insured entities and economic activity. Three years of stock market declines following the 2000 peak and the slow economic recovery have increased the risk and uncertainty for the pension benefit guaranty program by impairing the financial health of many pension funds and firms offering pension benefits. New and amended insurance programs for security-related risks also make the Federal Government's liability more uncertain. Security-related events such as terrorism and war are highly uncertain in terms of both the frequency of occurrence and the magnitude of potential loss.

II. PERFORMANCE OF CREDIT AND INSURANCE PROGRAMS

The Program Assessment Rating Tool (PART) produces an assessment of the performance of federal programs, which is designed to be consistent across programs. This section analyzes the PART score for credit and insurance programs as a group to identify the strengths and weaknesses of credit and insurance programs. Also discussed are special features of credit programs that may need to be considered in interpreting and refining the common assessment of performance.

PART Scores

The PART classifies performance into four categories (program purpose and design, strategic planning, program management, and program results) and assigns a numerical score (0 to 100 percent) to each category. For the final evaluation, the PART weights the four categories, placing a particularly heavy weight on program results.

There are 14 credit programs and 2 insurance programs among 399 programs that have been rated by the PART (excluding programs that were assessed for the 2004 Budget but are being reassessed as components of a different program in 2005 to avoid double-counting). Overall, the PART scores for credit and insurance programs are fairly similar to those for other programs (see Table "Summary of PART Scores"). When appropriately weighted, higher scores for credit and insurance programs in some categories are roughly offset by lower scores in other categories. A detailed analysis suggests that the dispersion of scores across programs is also similar for the two groups of programs.

Across categories, there are some similarities, as well as differences, between credit and insurance programs and other types of programs. For most programs, the scores are relatively high for program purpose and design and for program management, while the scores are low for program results. This general pattern holds for credit and insurance programs. Relative to other programs, however, credit and insurance programs scored low in program purpose and design and high in program management.

The PART indicates that most credit and insurance programs have clear purposes. Some credit and insurance programs, however, fail to score high in program design. Some are duplicative of other federal programs or private sources, and some have outdated designs due to failure to adapt to changed economic and financial environments. For example, Federal involvement in venture capital financing is difficult to justify, given that the venture capital market has matured.

Regarding strategic planning, many credit and insurance programs reveal the need to improve on setting targets and time frames for their long-term measures, evaluating program effectiveness and improvements on a regular basis, and tying budgets to accomplishment of performance goals.

Program management is a relatively strong area for credit and insurance programs. They are particularly

SUMMARY OF PART SCORES

Programs	Purpose and Design	Strategic Planning	Program Mgmt	Program Results	Rating
ED Student Loan Guarantees	60	75	33	53	Adequate
ED Direct Studen Loans	60	75	33	53	Adequate
ED Perkins Loans	20	50	33	0	Ineffective
SBA Section 504	60	50	100	60	Adequate
SBA Disaster Assistance	100	100	78	73	Moderately Effective
SBA SBIC Venture Capital	60	88	67	60	Adequate
FSA Loan Guarantees	100	63	100	67	Moderately Effective
RHS Community Facilities	80	50	100	33	Results Not Demonstrated
RUS Rural Electric Utility	80	17	90	25	Results Not Demonstrated
RUS Telecommunications	60	50	100	33	Results Not Demonstrated
RBS Business and Industry	80	75	100	33	Adequate
Ex-Im Bank L-T Guarantees	100	86	100	67	Moderately Effective
OPIC Insurance	100	75	100	42	Adequate
OPIC Finance	100	75	100	42	Adequate
Crop Insurance	80	67	86	58	Results Not Demonstrated
National Flood Insurance	90	86	100	67	Moderately Effective
Credit and Insurance Programs					
Average	77	68	83	48	
Standard Deviation	22	20	26	19	
Other Programs (all programs excluding credit and insurance programs)					
Average	85	70	79	47	
Standard Deviation	19	24	19	26	

strong in basic financial and accounting practices, such as spending funds for intended purposes. The financial complexity of credit and insurance programs may have forced program managers to develop better financial management tools. Nevertheless, some credit and insurance programs show weaknesses in more sophisticated financial management, such as cost control. Another weakness for some credit and insurance programs is in collecting and effectively utilizing performance information.

Program results, the most important category of performance, are a weak area for credit and insurance programs, as well as for other programs assessed by the PART. While most credit and insurance programs had some success in achieving short-term performance and efficiency goals, most of them have had trouble making progress toward long-term goals. A more troubling indication from detailed analyses is that many credit and insurance programs have a low PART score for program effectiveness and achieving results. Based on this finding, the managers of credit and insurance programs need to place much more emphasis on results-driven management.

Common Features

Credit programs share many features that distinguish them from other programs. For example, the cost is uncertain because of various risks, such as default risk, prepayment risk, and interest rate risk. Given these risks, risk management is an important aspect of credit programs. Most credit programs are also intended to address imperfections in financial markets. These common features are discussed in the context of the four areas of the PART. Although this section focuses on credit programs, much of the discussion also applies to insurance programs. For example, the cost is uncertain for insurance programs, too, because insured events occur unexpectedly. Financial market imperfections are also the main justification for insurance programs.

In analyzing the PART scores of credit programs, it is important to understand the common features of credit programs. Understanding common features facilitates the comparison of efficiency across credit programs and helps lead to improvements in performance. For example, if the PART score related to a common feature, such as risk management, is particularly low for a credit program, managers of the program may significantly improve performance by emulating the practice of other credit programs. A uniformly low PART score for all credit programs, on the other hand, may indicate that credit programs are facing a unique difficulty. In that case, program managers may need to make collective efforts to identify the difficulty and to address the problem. Individual efforts would be less efficient.

Program purpose and design. Program purposes widely vary across credit programs. They include increasing homeownership, increasing college graduates, promoting entrepreneurship, and promoting exports. The private market serves some of these distinctive purposes better now than it did in the past. Thus, it can be useful to compare the effects of changes in financial markets on the need for various credit programs.

Credit programs share many critical elements of design. Using the common tool, credit, they try to correct imperfections in financial markets. Thus, credit programs mostly target those borrowers who would not be able to obtain credit in the private market without government assistance. In addition, the lending business involves many complexities, such as setting appropriate lending terms, screening borrowers, and monitoring borrowers. Given these complexities, it is important to utilize the private sector's expertise. Targeting the right borrowers and utilizing the private sector's expertise require careful program design, which needs to consider various factors, such as borrowers' incentives, private lenders' incentives, the state of financial markets, and general economic conditions. Excessively low lending rates, for example, might attract many borrowers who could obtain credit from private lenders. To be effective, partnership with the private sector should be designed such that the private partner's profit is closely tied to its performance in achieving the public purpose. Private lenders are generally better at screening borrowers, but their incentive to screen borrowers effectively evaporates if the Government provides a 100-percent loan guarantee. Credit programs with low PART scores related to these aspects of program design may draw useful lessons from the practices of other credit programs.

Strategic planning. Credit programs operate in rapidly changing financial markets. Thus, an important aspect of strategic planning for credit programs is to adapt to changes in financial markets. To achieve the maximum efficiency, program managers need to watch closely and adapt their programs quickly to new developments. For example, private lenders are more willing to serve many customers to whom they did not want to lend in the past. Thus, some Federal credit programs may need to focus more narrowly on customers who are still underserved by private lenders. Quickly adopting new technologies is also important, because financial institutions are increasingly applying advanced technologies to risk management.

Program management. Some elements of program management are more important for credit programs than for other programs. To address these areas of special interest, the PART adds two extra items for credit programs: risk management and estimation models. Credit programs face similar risks in the lending business. To minimize the risks, program managers must carefully manage the loan portfolio that is held either directly or by private lenders. Once a loan defaults, effective collection efforts can reduce the loss. Estimating the program cost is a critical feature of credit programs. The cashflow is uncertain for credit programs. Some loans default, while some others are prepaid. The program cost must be estimated based on the expected default, prepayment, and recovery rates. This estimation is critical for program evaluation. Without knowing the cost, one cannot tell if a program is effective.

Some other management issues that apply to all government programs are particularly important for credit programs. Data collection is essential for effective risk management and cost estimation. Effective risk management requires accurate and timely information. Default and prepayment histories are key ingredients in cashflow estimation. In addition, accurate estimation requires detailed data on borrower and lender characteristics. Thus, managers of credit programs need to make extensive efforts to collect and process relevant information. To achieve efficiency and effectiveness, it is also important to have well organized procedures and to coordinate with other credit programs to carry out many complex functions, such as loan origination, loan servicing, lender monitoring, and collection of defaulted loans. Financial management is more challenging for credit programs because of the complex structure of cashflows.

Program Results. The main difficulty in evaluating program performance is to measure the net outcome of the program (improvement in the intended outcome net of what would have occurred in the absence of the program). For example, although many Federal programs help college students, it is difficult to tell how many of those would not have obtained a college education without Federal assistance. For credit programs, this difficulty is compounded by the uncertainty of the program cost. In evaluating programs, the outcome must be weighed against the cost. For a program intended to increase the number of college graduates, the relevant statistic is the number of college graduates due to the program per dollar spent by the program, not just the total number of college graduates produced by the program. For credit programs, the validity of this evaluation critically depends on the accuracy of the cost estimation. An underestimation (overestimation) of the cost would make the program appear unduly effective (ineffective). Thus, results for credit programs need to be interpreted in conjunction with the accuracy of the cost estimate. In some cases, whether a program's performance has improved over the past may be more meaningful than whether it performs better than others.

It is also important to evaluate credit programs in the context of changing financial markets. The financial sector is very dynamic, and the net outcome of a credit program may change quickly with the state of financial markets. The net outcome can decrease, as private entities become more willing to serve those customers whom they were reluctant to serve in the past, or it can increase if financial markets fail to function smoothly due to some temporary disturbances. A subpar performance by a credit program could be related to financial market developments; the program might fail to adapt to rapid changes in financial markets, or its function might become obsolete due to financial evolution. The program should be restructured in the former case, and discontinued in the latter case.

III. CREDIT IN FOUR SECTORS

Housing Credit Programs and GSEs

The Federal Government makes direct loans, provides loan guarantees, and enhances liquidity in the housing market to promote homeownership among low- and moderate-income people and to help finance rental housing for low-income people. While direct loans are largely limited to low-income borrowers, loan guarantees are offered to a much larger segment of the population, including moderate-income borrowers. Increased liquidity achieved through GSEs benefits virtually all borrowers in the housing market.

Federal Housing Administration

In June 2002, the President issued America's Homeownership Challenge to increase first-time minority homeowners by 5.5 million through 2010. During the first 15 months since the goal was announced, over one million minority families have become homeowners, setting a pace to exceed this goal. HUD's Federal Housing Administration (FHA) accounted for over 250,000 of these first-time minority homebuyers through its insurance funds, mainly the Mutual Mortgage Insurance Fund. FHA mortgage insurance provides access to homeownership for people who lack the financial resources or credit history to qualify for a conventional home mortgage. In 2003, FHA insured $159 billion in mortgages for over 1.3 million households. Most of these were people buying their first homes, many of whom were minorities. The dollar volume of FHA mortgages exceeded the 2002 volume by seven percent, driven by high housing demand and increased refinancings in response to lower interest rates.

For fiscal year 2005, FHA is proposing two new mortgage programs that reduce the biggest barriers to homeownership—the down payment and impaired credit. The Zero Down mortgage allows first-time buyers with a strong credit record to finance 100 percent of the purchase price and closing costs. For borrowers with limited or weak credit histories, Payment Rewards initially charges a higher insurance premium, but reduces the borrower's premiums once they have established a history of regular payments, thereby demonstrating their creditworthiness.

The Budget expands HUD's support for new homeowners by increasing funds for pre- and post-purchase housing counseling services through a network of counseling agencies. At the proposed funding level, almost 800,000 potential and existing homeowners will receive counseling in 2005.

The President's Management Agenda sets out several critical tasks for FHA to complete to combat fraud and improve risk management. In 2005, as in 2004, HUD will conduct quarterly rounds of Credit Watch—a lender monitoring program that rates lenders and underwriters by the performance of their loans and allows FHA to sever relationships with those showing poor performance. HUD also will have in place an automated system to enforce its regulations prohibiting the predatory practice of property flipping and will refine the Appraiser Watch system established in 2003 in order to closely monitor appraiser performance and hold appraisers accountable for the quality of their work. These efforts will reduce the possibility of improperly originated FHA loans that victimize the borrower and expose FHA to excessive losses.

VA Housing Program

The Department of Veterans Affairs (VA) assists veterans, members of the Selected Reserve, and active duty personnel to purchase homes as recognition of their service to the Nation. The program substitutes the Federal guarantee for the borrower's down payment. In 2003, VA provided $66 billion in guarantees to assist 508,436 borrowers. Both the volume of guarantees and the number of borrowers increased substantially from 2002 as lower interest rates increased loan originations and refinancings in the housing market.

Since the main purpose of this program is to help veterans, lending terms are more favorable than loans without a VA guarantee. In particular, VA guarantees zero down payment loans. The subsidy rate decreased due to an improved default rate methodology that more appropriately recognizes the relationship between defaults and interest rates.

In order to help veterans retain their homes and avoid the expense and damage to their credit resulting from foreclosure, VA plans aggressive intervention to reduce the likelihood of foreclosures when loans are referred to VA after missing three payments. VA was successful in 45 percent of its 2003 interventions, and its goal is to achieve at least a 47 percent success rate in 2005. VA is continuing its efforts to reduce administrative costs through restructuring and consolidations.

In order to refocus VA's housing loan program towards its original intent of serving as a readjustment benefit from military to civilian life, the Administration will be transmitting legislation that would limit eligibility for veterans' housing loans to one-time use in lieu of the lifetime multi-use entitlement it has become. For those who are already veterans upon enactment of this bill, the proposal allows unlimited usage for the next five years, and then only once thereafter. The proposal would not limit use by active duty members.

Rural Housing Service

The U.S. Department of Agriculture's (USDA's) Rural Housing Service (RHS) offers direct and guaranteed loans and grants to help very low- to moderate-income rural residents buy and maintain adequate, affordable housing. The single family guaranteed loan program guarantees up to 90 percent of a private loan for low to moderate-income rural residents. The program's emphasis is on reducing the number of rural residents living in substandard housing. In 2003, $3.1 billion of guarantees went to 31,100 households, of which 30 percent went to very-low and low-income families (with income 80 percent or less than median area income).

In 2002, RHS approved separate risk categories for guarantee refinancing (refis) and guarantees of new loans. As part of that change, RHS also reduced the guarantee fee to 0.5 percent for the refis. This change reflected the lower risk on refis as compared to an unseasoned borrower receiving a new loan. It is also consistent with the rate HUD and VA charge on their refis of similar loans. For 2005, RHS will increase the guarantee fee on new loans to 1.75 percent from 1.5 percent. This will be coupled with language that would allow the guarantee fee to be financed as part of the loan. The ability to finance the guarantee fee is more in line with the housing industry, including HUD and VA, and will allow more lower income rural Americans to realize the dream of home ownership.

In 2003, RHS continued to enhance a web-based system that will, with future planned improvements, provide the capacity to accept electronic loan originations from their participating lenders. RHS is also continuing development of an automated underwriting system (AUS) that will add significant benefits to loan processing efficiency, consistency and timeliness for RHS, the lenders, and customers. RHS continues to operate under the "best practice" for asset disposition for its guaranteed loan program. For single family guarantees, the lender is paid the loss claim, including costs incurred for up to three months after the default. After the loss claim is paid, RHS has no involvement in the property, and it becomes the sole responsibility of the lender for disposition. RHS is also developing the capacity to partner with lenders to seek recovery of loss claims from the former homeowner. They are also in the process of centralizing and automating the loss claim process to improve consistency and efficiency.

RHS programs differ from other Federal housing loan guarantee programs. RHS programs are means-tested and more accessible to low-income, rural residents. In addition, the RHS direct loan program offers deeper assistance to very-low-income homeowners by reducing the interest rate down to as low as 1 percent for such borrowers. The program helps the "on the cusp" borrower obtain a mortgage, and requires graduation to private credit as the borrower's income and equity in their home increases over time. The interest rate depends on the borrower's income. Each loan is reviewed annually to determine the interest rate that should be charged on the loan in that year based on the borrower's projected annual income. The program cost is balanced between interest subsidy and defaults. For 2005, RHS expects to provide $1.1 billion in loans with a subsidy cost of 11.58 percent.

RHS also offers multifamily housing loans, which includes farm labor housing loans. Direct loans are offered to private developers to construct and rehabilitate multi-family rental housing for very-low to low-income residents, elderly households, or handicapped individuals. As an incentive to the developers to provide low income rental housing in rural areas, these loans are heavily subsidized; the interest rate is between 1 and 2 percent. RHS rental assistance grants supplement the loan to the developer in the form of project based rent subsidies for very low-income rural households (for continuation of this assistance plus new commitments, the cost will be $592 million in 2005). RHS will address management issues in its multifamily housing portfolio in 2005 by restricting the $60 million loan level to repair and rehabilitation of its existing portfolio (17,400 projects, 446,000 units). Farm labor housing will have a program level of $59 million and will provide for new construction as well as repair/rehabilitation. RHS also offers guaranteed multifamily housing loans with a loan level of $100 million a year.

Housing GSEs

Three organizations were chartered by Congress to increase the flow of credit for housing. These government-sponsored enterprises (GSEs) are privately owned companies; the shares of two of them are listed on the New York Stock Exchange. They receive special benefits as a result of their Government sponsorship, including exemption from State and local taxes. Their missions are to increase the liquidity and improve the distribution of mortgage financing, particularly for low- and moderate-income borrowers. Two of the GSEs, Fannie Mae and Freddie Mac, primarily accomplish this mission by guaranteeing mortgages for sale as securities to investors. The third GSE, the Federal Home Loan Bank System, provides loans at preferred rates to member financial institutions. The three GSEs have grown significantly since they were chartered decades ago and are now three of the largest financial companies in the world.

The GSEs are increasingly in the asset management business, growing significant portfolios of mortgages

GROWTH OF THE GSEs IN THE LAST DECADE

Dollars in millions

	Balance Sheet Assets		Change	Balance Sheet Liabilities		Change
	1992	2002		1992	2002	
Fannie Mae	$ 172,055	$ 887,515	416%	$ 163,602	$ 871,227	433%
Federal Home Loan Bank System	$ 161,834	$ 763,631	372%	$ 151,210	$ 727,307	381%
Freddie Mac	$ 62,739	$ 752,249	1099%	$ 59,281	$ 718,610	1112%
Total	$396,628	$2,403,395	506%	$374,093	$2,317,144	519%

Note: Freddie Mac data not audited. Freddie Mac liabilities exclude minority interest in consolidated subsidiaries.

and mortgage-backed securities. The GSEs are highly leveraged, holding much less capital in relation to their assets than similarly sized financial institutions. A consequence of that highly leveraged condition is that a misjudgment or unexpected economic event could quickly deplete this capital, potentially making it difficult for a GSE to meet its debt obligations. Given the very large size of each enterprise, even a small mistake by a GSE could have consequences throughout the economy. More than six out of ten institutions in the banking industry hold as assets GSE debt in excess of 50 percent of their equity capital. As shown in the accompanying table (Growth of the GSEs in the Last Decade), the outstanding liabilities of the GSEs have grown by more than five hundred percent since 1992, to $2.3 trillion at the end of December 2002. For comparison, the privately held debt of the Federal Government at that time was $3.0 trillion.[1] In 2003, the Office of Federal Housing Enterprise Oversight (OFHEO), which oversees the safety and soundness of Fannie Mae and Freddie Mac, studied the risks posed by these GSEs to the financial system. Its study indicated that should a GSE experience large unexpected losses, the market for its and other GSEs' debt might become illiquid. Institutions holding this debt would see a rapid depletion in the value of their assets and a loss of liquidity, spreading the problems of the GSEs into financial sectors beyond the housing market.

Freddie Mac. In 2003, serious accounting problems surfaced at Freddie Mac, leading its Board of Directors in June to remove the company's top management, including its Chairman and CEO, its President and COO, and its Chief Financial Officer. This triggered multiple lawsuits on behalf of investors, and investigations by OFHEO, the Securities and Exchange Commission, and the Department of Justice, some still underway. The company restated its earnings, both up and down, over the period 2000–2002. OFHEO reported that Freddie Mac misstated its financial results and assessed Freddie Mac a monetary penalty of $125 million. The magnitude of the accounting restatement was large. The net impact is a cumulative increase of $5 billion in reported earnings over 2000–2002, which will result in a decrease in reported earnings in future years. Most of these amounts are linked to changes in the valuation of derivative financial instruments under relatively new accounting standards. The $5 billion increase in earnings represented over twenty percent of Freddie Mac's total capital available to cover losses and illustrates why an error by a GSE, intentional or not, may pose risks to investors. To date, Freddie Mac has made progress towards, but has not achieved, accurate and timely financial reporting and controls. Freddie Mac expects to provide an annual report for 2002 in the first quarter of 2004. Freddie Mac expects to publish 2003 results by June 2004.

Fannie Mae. Fannie Mae reported an accounting error in November 2003, requiring it to file a correction with the Securities and Exchange Commission. The correction of Fannie Mae's reported balance sheet showed a change of over $1 billion in shareholders' equity. The company reported that the error was unintentional, the result of a computational mistake made when implementing a new accounting standard. OFHEO has begun an investigation of the accounting practices at Fannie Mae.

Federal Home Loan Bank System. The Federal Home Loan Bank System, a cooperative of twelve regional banks that issue debt for which all are jointly and severally liable, suffered a significant decline in profits in 2003, primarily stemming from investment losses and a failure to hedge interest rate risk adequately at several Federal Home Loan Banks. As a result, one ratings organization downgraded its outlook for some individual banks of the 12-bank System.

The Administration stated in September and October 2003 that the Government's supervisory system for the three housing GSEs has neither the tools nor the stature to deal effectively with the current size, complexity, and importance of these companies. Department of the Treasury Secretary John Snow and then Department of Housing and Urban Development (HUD) Secretary Mel Martinez proposed a set of reforms on behalf of the Administration to give housing finance a regulatory framework as strong as those in place for other financial sectors. The reforms follow the principles accepted throughout the world as requirements for first-class regulation, based on a three-pronged regulatory approach: strong market discipline, effective supervision, and adequate capital requirements.

Market discipline. Chief among the factors that guide a company in its decision-making is the discipline imposed by the market. Market participants can signal to a company that it is making risky choices, for example, by charging the company more to borrow, or paying less for its stock. This discipline places constraints on companies. As Federal Reserve Chairman Alan Greenspan has noted, however, market discipline is not as strong for the GSEs as it is for other private companies. Some mistakenly perceive that GSE securities are backed by the Government—despite the fact that the Government explicity does not guarantee their securities. In both domestic and international markets, therefore, investors pay a premium for GSE debt by accepting a relatively low rate of return. As a result, the enterprises are able to finance their activities at a lower cost than others. The Congressional Budget Office estimated that in 2002 the value of the resulting subsidy exceeded $15 billion per year.

Market discipline also is hindered because GSE investors do not enjoy the same level of disclosure, or oversight of disclosures, as investors in fully private companies. The GSEs have a statutory exemption from the registration and disclosure requirements of the Securities and Exchange Commission (SEC). Recognizing this disadvantage to GSE investors, the Administration in 2002 called upon the three housing GSEs to register voluntarily their equity securities under the 1934 Secu-

[1] Privately held debt differs from debt held by the public (the measure generally used in the budget) by not including the Federal debt held by the Federal Reserve Banks.

rities Exchange Act, triggering mandatory SEC disclosures. To date, only Fannie Mae has complied, registering with the SEC in March 2003. Freddie Mac does not anticipate being in compliance until 2005, and the Federal Home Loan Bank System has not committed to comply voluntarily. The Federal Housing Finance Board has proposed a rule that would require each Federal Home Loan Bank to register voluntarily with the SEC under the 1934 Securities Exchange Act. Mandatory SEC disclosures would improve market discipline, and additional disclosures might further enhance investor awareness of and discipline over the GSEs' risk-taking.

Market discipline also requires that a company be controlled by those who represent the best interests of its owners. An independent Board of Directors, therefore, is essential. A board unduly influenced by the company's management may have reason not to provide investors timely and adequate information. In 2002, the President established a 10-point plan for corporate governance practices that emphasized the importance of corporate board independence. In addition, the Administration proposed in 2003 to eliminate the Presidential appointees to the Fannie Mae and Freddie Mac Boards.

Supervision. An effective financial regulator must possess authorities and capabilities commensurate with its responsibilities. The Administration has determined that the safety and soundness regulators of the housing GSEs lack sufficient powers and stature to meet their responsibilities, and therefore that both OFHEO, regulator of Fannie Mae and Freddie Mac, and the Federal Housing Finance Board, regulator of the Federal Home Loan Bank System, should be replaced with a new, strengthened regulator.

The Administration has proposed a new regulator, empowered with expanded enforcement authorities, independent litigation authority, receivership authority, and control over its funding levels independent of Congressional appropriations. It regards such authorities as essential to a world-class regulator.

A new regulator must have full authority together with accountability for the prudential supervision of the enterprises, which includes the authority to approve new activities of the enterprises. Under current law, the responsibility for new program approval of Fannie Mae and Freddie Mac has been split between OFHEO, an independent agency within HUD, and HUD itself. Neither, therefore, is fully accountable for this key element of effective supervision of these two large and complex entities. The Administration's proposal would remedy this by establishing a single new regulator with consolidated responsibility for the prudential operation of Fannie Mae, Freddie Mac, and the Federal Home Loan Banks, as well as authority to review their ongoing business activities and reject new ones proposed by the GSEs, if they would be inconsistent with the charter or prudential operations of the GSEs, or incompatible with the public interest. HUD would continue to be consulted on new activities.

A new regulator must have the stature to avoid regulatory capture, i.e., undue influence by the entities it regulates. This is difficult for a regulator of a small number of very large entities. The Administration proposes placing the new regulator within the Department of the Treasury to provide the necessary stature and other supervisory benefits, provided the Department is given adequate oversight authority. The Administration, however, does not support an outcome that would create the illusion of greater oversight by the Treasury without the authority to make it a reality.

Capital requirements. Because neither investors nor regulators can predict all of the impacts of possible errors by a company or unexpected economic changes, requirements that ensure that the GSEs hold capital adequate to cushion such shocks are essential. Capital requirements must be set with an eye to both known risks and unknown or unquantifiable risks. Losses from these latter risks can well exceed losses from measured risks, as shown by the rapid depletion of capital in 1998 for the highly leveraged hedge fund, Long-Term Capital Management. For this reason, it is essential that the new regulator of the housing GSEs have ongoing authority to adjust both risk-based and minimum capital requirements. The accompanying table (Capital Held by the GSEs and 10 of the Largest U.S. Financial Institutions) contrasts the capital held by the GSEs with that held by similarly sized financial institutions. On average, the GSEs hold less than one-half the capital of these other companies.

Risks, and how they are measured, evolve over time. The Administration proposes to give the new GSE regulator full flexibility to establish risk-based capital standards. The current risk-based capital standards for Fannie Mae and Freddie Mac are rigidly defined by a 10-year old statute. The risk-based capital standards for the Federal Home Loan Bank System, while more flexible, have not been fully implemented.

Affordable housing mission. As noted above, many investors perceive an implicit guarantee of GSE securities by the Government, and convey a large subsidy to the GSEs by paying a premium for their securities. Fannie Mae and Freddie Mac purchase two-thirds of all single-family mortgages originated (non-governmental, non-jumbo). With this large subsidy, and with their substantial market share, the GSEs conceivably could have a considerable impact on lowering mortgage costs. Yet the Congressional Budget Office estimated in 2001 that Fannie Mae and Freddie Mac lower mortgage rates by no more than 25 basis points, or one-quarter of one percentage point. A 2003 working paper by a member of the Federal Reserve Board staff estimates that the two GSEs lower mortgage rates by an even smaller amount. At the higher estimate of 25 basis points, a homeowner saves about $25 on the monthly payment for a median-priced $160,000 thirty-year mortgage. One reason the effect is not larger is that Fannie Mae and Freddie Mac do not pass through the entire subsidy to mortgage borrowers. According to CBO, 37 percent is retained by the companies, their executives,

CAPITAL HELD BY THE GSEs AND 10 OF THE LARGEST U.S. FINANCIAL INSTITUTIONS

(Dollars in millions; December 31, 2002)

Companies ranked by assets	Balance Sheet Assets	Stock-holders' Equity	Capital Ratio: Equity to Assets
Citigroup Inc	$1,097,190	$86,718	7.9%
Fannie Mae	$887,515	$16,288	1.8%
Federal Home Loan Bank System	$763,631	$36,324	4.8%
JP Morgan Chase & Co	$758,800	$42,306	5.6%
Freddie Mac	$752,249	$31,330	4.2%
Bank of America Corp	$660,458	$50,319	7.6%
Wells Fargo & Co	$349,259	$30,358	8.7%
Wachovia Corp	$341,839	$32,078	9.4%
Bank One Corp	$277,383	$22,440	8.1%
Washington Mutual Inc	$268,298	$20,134	7.5%
FleetBoston Financial Corp	$190,453	$16,833	8.8%
US Bancorp	$180,027	$18,101	10.1%
American Express Company	$157,253	$13,861	8.8%
Average all companies	....	....	7.2%
Average GSEs	....	....	3.6%
Average excluding GSEs	....	....	8.2%

Notes: In addition to GSEs, this table includes the ten largest publicly traded U.S. companies in the finance industry, in terms of balance sheet assets, excluding insurance companies and security brokers and dealers. Capital defined as stockholders' equity. Financial regulators may use an alternative definition of capital.

Data sources: Securities and Exchange Commission public filings, Federal Home Loan Bank System Office of Finance, and Freddie Mac. Freddie Mac data not audited.

shareholders, or other stakeholders. Current market and regulatory mechanisms are not sufficient to force the GSEs to pass on greater savings to borrowers.

To encourage the GSEs to use their Government sponsorship to benefit those less likely to have access to mortgage credit and households with moderate or low incomes, the governing statutes require them to address affordable housing needs. For Fannie Mae and Freddie Mac, HUD is required to set and enforce annual housing goals. These require that a certain percentage of the two companies' mortgage purchases be mortgages for low- and moderate-income borrowers or from geographic areas that have been underserved by the market. For the Federal Home Loan Bank System, the Federal Housing Finance Board enforces a requirement to dedicate 10 percent of the System's profits to affordable housing and to provide subsidized loans to members' community investment programs. Given the different methods used to convey affordable housing subsidies, comparing the relative efforts of the Federal Home Loan Bank System with Fannie Mae and Freddie Mac is not simple. Comprehensive research in this area has not been undertaken. Such a comparative analysis would be useful to policy makers and GSE regulators.

The Administration has identified weaknesses in the system for setting and enforcing the affordable housing goals for Fannie Mae and Freddie Mac. These weaknesses could result in their failure to perform the targeted housing mission for which they were created. For example, HUD needs new administrative authority to enforce the goals. Current law does not permit the Secretary to impose timely and appropriate penalties for a GSE's failure to meet a goal. This authority is necessary to ensure that the goals are strict requirements that the GSEs must meet.

The Administration also has proposed that these two GSEs be required to meet a national home purchase goal, a tool specifically to promote affordable homeownership, particularly for first-time homebuyers. This goal would ensure that the GSEs' activities support home purchases, even in years when refinance activity is high. Although Fannie Mae and Freddie Mac provide liquidity in the refinance market, the share of funding they provide for home purchases declines during years when many mortgages are refinanced.

HUD has conducted analyses showing that private lenders operating without the benefits and subsidies enjoyed by the GSEs contribute more to affordable housing than do Fannie Mae and Freddie Mac. For example, during 1999–2002, home loans for low- and moderate-income families accounted for 44.3 percent of all home purchase mortgages originated by lenders in the conventional conforming market. Yet these loans accounted for only 42.5 percent of Fannie Mae's purchases and 42.3 percent of Freddie Mac's purchases. The GSEs particularly lag the market in funding first-time homebuyers. First-time homebuyers accounted for 26.5 percent of each GSE's purchases of mortgages used to buy homes, compared with 37.6 percent of home purchase mortgages originated in the conventional conforming market.

The GSEs' risk management affects not only their owners and investors, but the entire financial system. Despite their Government sponsorship and mission, the GSEs do not lead the market in creating homeownership opportunities for less advantaged Americans. The

Administration's proposed reforms to the supervisory system for the GSEs address these problems by promoting a strong and resilient financial system, while increasing opportunities for affordable housing and homeownership.

Education Credit Programs and GSEs

The Federal Government guarantees loans through intermediary agencies and makes direct loans to students to encourage post-secondary education. The Student Loan Marketing Association (Sallie Mae), a GSE, makes secondary market purchases of guaranteed student loans from banks and other eligible lenders.

Student Loans

The Department of Education helps finance student loans through two major programs: the Federal Family Education Loan (FFEL) program and the William D. Ford Federal Direct Student Loan (Direct Loan) program. Eligible institutions of higher education may participate in one or both programs. Loans are available to students regardless of income. However, borrowers with low family incomes are eligible for loans with additional interest subsidies. For low-income borrowers, the Federal Government subsidizes loan interest costs while borrowers are in school, during a six-month grace period after graduation, and during certain deferment periods.

In 2005, nearly 9 million borrowers will receive over 14.5 million loans totaling over $85 billion. Of this amount, nearly $57 billion is for new loans, and the remainder reflects the consolidation of existing loans. Loan levels have risen dramatically over the past 10 years as a result of rising educational costs and an increase in eligible borrowers.

The FFEL program provides loans through an administrative structure involving over 3,500 lenders, 36 State and private guaranty agencies, roughly 50 participants in the secondary market, and approximately 6,000 participating schools. Under FFEL, banks and other eligible lenders loan private capital to students and parents, guaranty agencies insure the loans, and the Federal Government reinsures the loans against borrower default. In 2005, FFEL lenders will disburse over 11 million loans totaling almost $65 billion in principal, roughly a third of which involve consolidations of existing loans. Lenders bear two percent of the default risk, and the Federal Government is responsible for the remainder. The Department also makes administrative payments to guaranty agencies and, at certain times, pays interest subsidies on behalf of borrowers to lenders.

The William D. Ford Direct Student Loan program was authorized by the Student Loan Reform Act of 1993. Under the Direct Loan program, the Federal Government provides loan capital directly to more than 1,100 schools, which then disburse loan funds to students. In 2005, the Direct Loan program will generate more than 3.5 million loans with a total value of nearly $21 billion, including over $6 billion in consolidations of existing loans. The program offers a variety of flexible repayment plans including income-contingent repayment, under which annual repayment amounts vary based on the income of the borrower and payments can be made over 25 years with any residual balances forgiven.

The Congress is currently considering legislative reforms to both FFEL and DL as part of this year's Higher Education Act reauthorization. These reforms come at a critical time with college costs continuing to rise at increasing rates and the widening gap between the number of high income and low income students that attend college. The President's Budget proposes several legislative changes to the student loan programs to help make college more affordable for millions of students while making both student loan programs more cost efficient. To help students meet rising tuition costs, the Budget proposes to increase loan limits for first year students, retain variable interest rates beyond 2006 so students can continue to take advantage of historically low interest rates, expand borrower repayment options, and increase loan forgiveness for highly qualified teachers who teach math, science, or special education for five years in high-need schools. To fund these changes, the Administration proposes to reduce program costs through modest changes to lender subsidies and Guaranty Agency fees. For example, the Budget proposes to eliminate an expensive loophole that provides lenders with a federally financed 9.5% guaranteed return on loans that are tied to out-dated tax exempt bonds.

The Administration's proposed changes are consistent with the PART findings for the student loan programs, which found that program benefits were not well targeted to student borrowers while they are attending school. The PART also found that both programs could meet their goals in a more cost effective manner if financial benefits for program participants were more closely tied to market realities. The PART generated specific proposals for addressing these areas, many of which are included in the HEA reforms package in the President's Budget.

Sallie Mae

The Student Loan Marketing Association (Sallie Mae) was chartered by Congress in 1972 as a for-profit, shareholder-owned, Government-sponsored enterprise (GSE). Sallie Mae was reorganized in 1997 pursuant to the authority granted by the Student Loan Marketing Association Reorganization Act of 1996. Under the Reorginization Act, the GSE became a wholly owned subsidiary of SLM Corporation and must wind down and be liquidated by September 30, 2008. In January 2002, the GSE's board of directors announced that it expects to complete dissolution of the GSE by September 30, 2006. The Omnibus Consolidated and Emergency Supplemental Appropriations Act of 1999 allows the SLM Corporation to affiliate with a financial institution upon the approval of the Secretary of the Treasury. Any affiliation will require SLM Corporation to dissolve the GSE within two years of the affiliation date (unless such period is extended by the Department of the Treasury).

Sallie Mae makes funds available for student loans by providing liquidity to lenders participating in the FFEL program. Sallie Mae purchases guaranteed student loans from eligible lenders and makes warehousing advances (secured loans to lenders). Generally, under the privatization legislation, the GSE cannot engage in any new business activities or acquire any additional program assets other than purchasing student loans. The GSE can continue to make warehousing advances under contractual commitments existing on August 7, 1997. SLM Corporation and its affiliates, including the GSE, currently hold approximately 38 percent of all outstanding guaranteed student loans.

Business and Rural Development Credit Programs and GSEs

The Federal Government guarantees small business loans to promote entrepreneurship. The Government also offers direct loans and loan guarantees to farmers who may have difficulty obtaining credit elsewhere and to rural communities that need to develop and maintain infrastructure. Two GSEs, the Farm Credit System and the Federal Agricultural Mortgage Corporation, increase liquidity in the agricultural lending market.

Small Business Administration

The Small Business Administration (SBA), created in 1953, helps entrepreneurs start, sustain, and grow small businesses. As a “gap lender” SBA works to supplement market lending and provide access to credit where private lenders are reluctant to do so without a Government guarantee. Additionally, SBA assists home- and business-owners cover the uninsured costs of recovery from disasters.

The 2005 Budget requests $326 million, including administrative funds, for SBA to leverage nearly $25 billion in financing for small businesses and disaster victims. The 7(a) General Business Loan program will support $12.5 billion in guaranteed loans—a more than 25 percent increase over 2004—while the 504 Certified Development Company program will support $4.5 billion in guaranteed loans. SBA will supplement the capital of Small Business Investment Companies (SBICs), which provide equity capital and long-term loans to small businesses, with up to $7 billion in participating securities and guaranteed debentures.

To continue to serve the needs of small businesses, SBA will focus program management in three areas:

1) Targeting economic assistance to the neediest small businesses

SBA seeks to target assistance more effectively to credit-worthy borrowers who would not be well-served by the commercial markets in the absence of a Government guarantee to cover defaults. SBA is actively encouraging financial institutions to increase lending to start-up firms, low-income entrepreneurs, and borrowers in search of financing below $150,000. Preliminary evidence shows that SBA’s outreach for the 7(a) program has been successful. Average loan size has decreased from $258,000 in 2000 to $167,000 in 2003, while the number of small businesses served has grown from 43,748 to 67,306 during the same time period. In addition, SBA issued new regulations for the Section 504 program that foster additional competition among intermediaries, thereby allowing borrowers greater access to loans.

2) Improving program and risk management

Improving management by measuring and mitigating risks in SBA’s $45 billion business loan portfolio is one of the agency’s greatest challenges. As the agency delegates more responsibility to the private sector to administer SBA guaranteed loans, oversight functions become increasingly important. SBA established the Office of Lender Oversight, which is responsible for evaluating individual SBA lenders. This office has made progress in employing a variety of analytical techniques to ensure sound financial management by SBA and to hold lending partners accountable for performance. These analytical techniques include financial performance analysis, industry concentration analysis, portfolio performance analysis, selected credit reviews, and credit scoring to compare lenders’ performance. The oversight program is also developing on-site safety and soundness examinations and off-site monitoring of Small Business Lending Companies (SBLCs) and compliance reviews of SBA lenders. In addition, the office will develop incentives for lenders to minimize defaults and to adopt sound performance measures.

Improving risk management also means improving SBA’s ability to more accurately estimate the cost of subsidizing small businesses. During 2003, the SBA followed through on its commitment to improve its accuracy in estimating the cost of the Section 7(a) General Business Loan program by developing a loan-level econometric credit and reestimate model for the program. The improved model should help SBA avoid repeating its experience during the 1990’s, when subsidy costs for the 7(a) program were overestimated by $1 billion. (These subsidy overestimates, however, were significantly offset by program administrative costs during the same period.) More recent analysis, using the new model, shows that during the last few years the 7(a) program has cost almost $230 million more than previously estimated. Building upon the 7(a) modeling improvements, a comparable model was developed for the 2005 subsidy estimates for the Section 504 loan program.

Improving risk management is especially important for the Small Business Investment Company (SBIC) venture capital program. Like the private venture capital market, performance in the SBIC program began to decline in 2000. The SBIC program is now expected to cost taxpayers approximately $2 billion due to defaults and other cash loses. In addition to the overall market decline, the poor performance in the SBIC program is due to the following structural flaws.

- The Federal Government's financial returns are not proportional to its investment. SBA invests up to two-thirds of total funds but, on average, receives only about ten percent of SBICs' profits. Ninety percent of those profits were generated by only 14 of 170 SBICs licensed in the Participating Securities program since 1994.
- SBICs do not have adequate incentives to pay back funds expeditiously to the Government. Under the current statute, SBICs make "profit" payments to SBA but these are generally insufficient to repay the original principal investment in a timely manner which extends SBA's risk exposure.
- The prior subsidy model underestimated the cost of the program. The technical assumptions (e.g., defaults, recoveries, and profits) have turned out to be more optimistic than actual program performance.

The 2005 Budget takes steps to address the first of these issues by proposing to increase borrowers' fees and SBA's share of profits in the SBIC Participating Securties program. The Budget also proposes to accelerate repayments to the Government. In addition, the subsidy model for the Participating Securities program has been improved by incorporating more realistic technical assumptions, which are generally based upon historical experience. During 2004, SBA expects to reexamine the methodology used to calculate the cost to subsidize the SBIC Participating Securities program. With realized and projected losses of about $2 billion (reflected in an upward mandatory subsidy reestimate) on an outstanding portfolio of about $5 billion, these steps are critical if the program is to be fiscally sound and not rely on large taxpayer subsidies.

SBA is improving oversight and accounting practices of its Secondary Market Guarantee (SMG) program for 7(a) guaranteed loans. To properly manage any risk associated with this fund which is authorized under section 5(g) of the Small Business Act, SBA is budgeting for the Government's liability in accordance with the Federal Credit Reform Act. In accordance with the commitment that SBA made last year, it refined its estimate of the Government's liability for the program, which is reflected in the $105 million upward mandatory reestimate cost in the 2005 budget. Due to reforms that are being implemented in 2004, this program will not require discretionary subsidy appropriations to operate in 2005.

In 1999, SBA initiated an asset sales program as a means of improving portfolio management and curtailing the growing level of assets—primarily disaster loans—serviced by SBA. More than $5 billion in direct and repurchased (defaulted) guaranteed loans were sold to investors in seven separate sales through 2002. These assets were sold to private sector buyers without any recourse for future default claims or interest supplements from the Government. While the sales reduced loan management burdens on SBA, discrepancies eventually appeared between accounting and budgetary records; the agency's financial statements indicated losses on the program of $1.8 billion while the model used to value loans for purposes of sales showed gains of approximately $800 million. SBA and the General Accounting Office attempted to identify the source of the discrepancies in early 2002, but neither was able to explain the inconsistencies. As a result, SBA assembled a team of financial experts and undertook a detailed review of the financial records relating to the program between October 2002 and February 2003. The assessment revealed three sources of discrepancies. First, accounting entries overstated loan values and did not fully reconcile to subsidy estimates. Second, the agency's credit subsidy model, which assessed costs at an aggregate program level, did not always provide reliable loan cost estimates. Third, the model used to provide individual loan values for asset sales significantly underestimated the worth of those assets and did not reconcile to the subsidy model. Because of the findings, SBA halted its eighth sale scheduled for April 2003 and all subsequent sales. In addition, SBA has adjusted its accounting records and developed a single new loan-level credit model that can also determine the value of individual loans proposed for sale. Adjustments in the financial records have revealed that selling repurchased SBA guaranteed loans was profitable, while the sale of performing disaster loans resulted in budgetary costs to the Federal Government. On net, SBA's asset sales program has resulted in an $828 million loss.

3) Operating more efficiently

To operate more efficiently, SBA has automated loan origination activities in the Disaster Loan program with a paperless loan application. As a result, loan-processing costs, times, and errors will decrease, while Government responsiveness to the needs of disaster victims will increase. SBA is also transforming the way that staff perform loan management functions in both the 7(a) and 504 programs. In 2003, SBA implemented a pilot program at three of its 68 district offices to consolidate and expedite Section 504 loan processing. Results have been very positive with the average loan processing time reduced from four weeks to only a few days. SBA is expanding the pilot nationally. Similarly, SBA is also shifting additional responsibilities to intermediaries by centralizing loan liquidation functions for the Section 504 program and requiring intermediaries to assume increased liquidation responsibilities.

USDA Rural Infrastructure and Business Development Programs

USDA provides grants, loans, and loan guarantees to communities for constructing facilities such as health-care clinics, day-care centers, and water and wastewater systems. Direct loans are available at lower interest rates for the poorest communities. These programs have very low default rates. The cost associated with them is due primarily to subsidized interest rates that are below the prevailing Treasury rates.

The program level for the Water and Wastewater (W&W) treatment facility loan and grant program in the 2005 President's Budget is $1.4 billion. These funds are available to communities of 10,000 or less residents. The program finances W&W facilities through direct or guaranteed loans and grants. Applicant communities must be unable to finance their needs through their own resources or with commercial credit. Priority is given based on their median household income, poverty levels, and size of service population as determined by USDA. The community typically receives a grant/loan combination. The grant is usually for 35–45% of the project cost (it can be up to 75%). Loans are for 40 years with interest rates based on a three-tiered structure (poverty, intermediate, and market) depending on community income. The community facility programs are targeted to rural communities with fewer than 20,000 residents and have a program level of $527 million in 2005. USDA also provides grants, direct loans, and loan guarantees to assist rural businesses, including cooperatives, to increase employment and diversify the rural economy. In 2005, USDA proposes to provide $600 million in loan guarantees to rural businesses (these loans serve communities of 50,000 or less).

These community programs are all part of the Rural Community Advancement Program (RCAP). Under RCAP, States have increased flexibility within the three funding streams for Water and Wastewater, Community Facilities, and Business and Industry (B&I). USDA also provides loans through the Intermediary Relending Program (IRP), which provides loan funds at a 1 percent interest rate to an intermediary such as a State or local government agency that, in turn, provides funds for economic and community development projects in rural areas. In 2005, USDA expects to retain or create over 66,000 jobs through its business programs, which will be achieved primarily through the B&I guarantee and the IRP loan programs.

Electric and Telecommunications Loans

USDA's Rural Utilities Service (RUS) has programs that provide loans for rural electrification, telecommunications, distance learning, telemedicine, and broadband and grants for distance learning and telemedicine. The electric and telecommunications program makes new loans to maintain existing infrastructure and to modernize electric and telephone service in rural America. Historically, the Federal risk associated with the $40 billion loan portfolio in electric and telephone loans has been small, although several large defaults have occurred in the electric program.

The Distance Learning and Telemedicine (DLT) provides loans and grants to improve distance learning and telemedicine services in rural areas and encourage students, teachers, medical professionals, and rural residents to use telecommunications, computer networks, and related advanced technologies. The USDA Broadband programs provide loans to provide broadband service to rural communities.

The subsidy rates for several of the electric and telecommunication programs remain negative, though changes to the interest rate assumptions resulted in positive subsidy rates for the Electric Hardship and Municipal rate programs. Recent problems in the telecommunications industry have not had a significant impact on rural telecommunications cooperatives. The number of electric loans has been increasing due to large increases in loan level appropriated over the last several years. The average size for electric loans has also been increasing. The number and the size of telecommunications loans have remained steady. The subsidy rate for the DLT loan program increases in FY2005 from negative to positive due to a few defaults that were not included in the original assumptions. The Broadband subsidy rates increase slightly due to interest rate assumption changes.

Providing funding and services to needy areas is of concern to USDA. Many rural cooperatives provide service to areas where there are high poverty rates. Based on PART findings, USDA will review its current method of issuing telecommunications loans, '"first in; first out," to determine if it allows for adequate support for areas with the highest priority needs. In addition, to ensure the electric and telecommunications programs' focus on rural areas, legislation will be proposed to require recertification of rural status for each electric and telecommunications borrower on the first loan request received in or after FY 2005 and on the first loan request received after each subsequent Census. Legislation will be sought to allow for the rescission of loans that are more than ten years old.

RUS proposes to make $2.5 billion in direct and guaranteed electric loans in 2005, including provision for guaranteeing $100 million in electric loans made by private banks. The demand for loans to rural electric cooperatives has been increasing and is expected to increase further as borrowers replace many of the 40-year-old electric plants. With the $2.5 billion in loans, RUS borrowers are expected to upgrade 225 rural electric systems, which will benefit over 3.4 million customers.

USDA's RUS proposes to make $495 million in direct telecommunications loans in 2005. With the $495 million in loans, RUS borrowers are expected to fund over 50 telecommunication systems for advanced telecommunications services which will provide broadband and high-speed Internet access and benefit over 300 thousand rural customers.

With the $25 million in DLT grants RUS borrowers are expected to provide distance learning facilities to 300 schools, libraries, and rural education centers and also provide telemedicine equipment to 150 rural health care providers, benefiting millions of residents in rural America. Loan funds are not provided due to the positive subsidy rate and the lack of interest in DLT loans. The budget proposes converting the mandatory broadband funding into discretionary funding and provides discretionary funding that supports $331 million in broadband loans.

Loans to Farm Operators

Farm Service Agency (FSA) assists low-income family farmers in starting and maintaining viable farming operations. Emphasis is placed upon aiding beginning and socially disadvantaged farmers. FSA offers operating loans and ownership loans, both of which may be either direct or guaranteed loans. Operating loans provide credit to farmers and ranchers for annual production expenses and purchases of livestock, machinery, and equipment. Farm ownership loans assist producers in acquiring and developing their farming or ranching operations. As a condition of eligibility for direct loans, borrowers must be unable to obtain private credit at reasonable rates and terms. As FSA is the "lender of last resort," default rates on FSA direct loans are generally higher than those on private-sector loans. However, in recent years the loss rate has decreased with a rate of 5.1 percent in 2003, compared to 5.6 percent in 2002.

FSA guaranteed farm loans are made to more creditworthy borrowers who have access to private credit markets. Because the private loan originators must retain 10 percent of the risk, they exercise care in examining the repayment ability of borrowers. As a result, losses on guaranteed farm loans remain low with default rates of .71 percent in 2003 as compared to .70 percent in 2002.

The 2002 Farm Bill changed some of the requirements for managing inventory property. Property acquired through foreclosure on direct loans must now be sold at auction within 165, rather than 105 days of acquisition. The new rule allows more time to advertise and encourage participation from beginning farmers.

The subsidy rates for these programs have been fluctuating over the past several years. These fluctuations are mainly due to the interest component of the subsidy rate. The default rates for these programs tend to be below ten percent. As shown above, both the direct and guaranteed loans have experienced a decreasing default rate.

In fiscal year 2003, FSA provided loans and loan guarantees to approximately 32,000 family farmers totaling $3.94 billion. The number of loans provided by these programs has fluctuated over the past several years. The average size for farm ownership loans has been increasing. The majority of assistance provided in the operating loan program is to existing FSA farm borrowers. In the farm ownership program, new customers receive the bulk of the benefits furnished.

In the last few years, the demand for FSA direct and guaranteed loans has been high due to crop/livestock price decreases and some regional production problems. In 2005, USDA's FSA proposes to make $3.8 billion in direct and guaranteed loans through discretionary programs.

A PART evaluation of the guaranteed loan portfolio was conducted in 2003. The review found that the program is well-managed and serves a clear purpose in helping farmers who have difficulty in demonstrating creditworthiness obtain credit at reasonable rates from private lenders. However, while the program has a low loss rate, it is unable to adequately demonstrate whether it is achieving the objective of improving the economic viability of U.S. farmers and ranchers. Over the next year, FSA will be conducting an in-depth review of its direct and guaranteed loan portfolios to assess program performance, including the effectiveness of targeted assistance and the ability of borrowers to graduate to private credit.

The Farm Credit System and Farmer Mac

The Farm Credit System (FCS or System) and the Federal Agricultural Mortgage Corporation (Farmer Mac) are Government-Sponsored Enterprises (GSEs) that enhance credit availability for the agricultural sector. The FCS provides production, equipment, and mortgage lending to farmers and ranchers, aquatic producers, their cooperatives, and related businesses, while Farmer Mac provides a secondary market for agricultural real estate and rural housing mortgages.

The Nation's agricultural sector and, in turn, its lenders continue to exhibit stability in their income and balance sheets. This is due, in part, to government assistance payments being provided from 1998 through 2003. Also, the low interest rate environment seen over the past two years has reduced interest expense for the capital-intensive agricultural sector and bolstered farmland values. Favorable growing conditions were widespread, and commodity prices generally rose in 2003, although weakness continued for some products. Farmland values increased moderately, up 5.0 percent in 2002, due to a combination of government payments, urban influences, and declining interest rates. Projections for 2003 see a smaller rise of 3.0 percent for farmland values

Commercial banks maintained their predominant farm debt market share of 40 percent in 2002. The FCS trailed at a 29.8 percent share. The United States Department of Agriculture (USDA) direct farm loan programs market share was 3.7 percent, though it would more than double if adjusted for guaranteed loans issued through private institutional lenders. In 2003, USDA expects the market-share gap between commercial banks and the FCS to have narrowed marginally.

The Farm Credit System

During 2003, the financial condition of the System's banks and associations continued a 15-year trend of improving financial health and performance. Sound asset quality and strong income generation enabled FCS banks and associations to post record capital levels. As of September 30, 2003, capital increased 6.4 percent for the year and stood at $16.2 billion. These capital numbers exclude $2.0 billion of restricted capital held by the Farm Credit System Insurance Corporation (FCSIC). Loan volume has increased since 1989 to $91.3 billion in September 2003, which surpasses the high of $90.0 billion, set in December 2002. The rate of asset growth for the preceding three-year period (2000–2002) has been averaging 7.6 percent. However, the rate of capital accumulation has been greater resulting in total capital equaling 15.4 percent of total assets at yearend 2002 compared to 14.9 percent at yearend 1999. Nonperforming assets increased slightly to 1.4 percent of the portfolio in September 2003 compared to 1.3 percent in December 2002. Competitive pressures and a falling interest rate environment have narrowed the FCS's net interest margin to 2.62 percent in September 2003 from 2.76 percent in 2002. The net interest margin is expected to remain stable in the near-term, given the expectations for a continued low interest rate environment into 2004. Consolidation continues to affect the structure of the FCS. In January 1995, there were nine banks and 232 associations; by September 2003, there were six banks and 99 associations.

The FCSIC ensures the timely payment of interest and principal on FCS obligations. FCSIC's net assets, largely comprised of premiums paid by FCS institutions, supplement the System's capital and support the joint and several liability of all System banks for FCS obligations. On September 30, 2003, FCSIC's net assets totaling $1.7 billion were slightly below (1.98 percent) the statutory minimum of 2.0 percent of outstanding debt. In 2003, the premium rate was increased to bolster FCSIC's net assets to meet the expansion in the System's outstanding debt caused by strong growth in its asset base. The premium rate is slated to be reduced slightly in 2004.

Improvement in the FCS's financial condition is also reflected in the examinations by the Farm Credit Administration (FCA), its Federal regulator. Each of the System institutions is rated under the FCA Financial Institution Rating System (FIRS) for capital, asset quality, management, earnings, liquidity, and sensitivity. At the beginning of 1995, 197 institutions carried the best FIRS ratings of 1 or 2, 36 were rated 3, one institution was rated 4, and no institutions received the lowest rating of 5. In September 2003, all 105 banks and associations had ratings of 1 or 2 and no institution was under an enforcement action.

Over the past 12 months, the System's loans outstanding have grown by $3.4 billion, or 3.9 percent, while over the past five years they have grown $25.2 billion, or 38.1 percent. The volume of lending secured by farmland increased 52.6 percent, while farm-operating loans have increased 32.1 percent since 1998. Total members served increased about 2 percent during the past year. Agricultural producers represented the largest borrower group, with $72.8 billion including loans to rural homeowners and leases, or just under 80 percent of the dollar amount of loans outstanding. As required by law, all borrowers are also stockholder owners of System banks and associations. The System has more than 453,000 stockholders; about 83 percent of these are farmers with voting stock. Over half of the System's total loan volume outstanding (53.6 percent) is in long-term real estate loans, over one-quarter (26.2 percent) is in short- and intermediate-term loans to agricultural producers, and 17 percent is to cooperatives. International loans (export financing) represent 3.2 percent of the System's loan portfolio. Young, beginning, and small farmers and ranchers loans represented 12.7, 18.0, and 30.1-percent, respectively, of the total dollar volume outstanding in 2002, which is slightly higher than in 2001. These percentages cannot be summed given significant overlap in these categories. Providing credit and related services to young, beginning, and small farmers and ranchers is a legislated mandate and a high priority for the System.

The System, while continuing to record strong earnings and capital growth, remains exposed to numerous risks, including concentration risk, changes in government assistance payments, the volatility of exports and crop prices, and lower non-farm earnings of farm households associated with weakness in the economy's employment sector.

Farmer Mac

Farmer Mac was established in 1987 to facilitate a secondary market for farm real estate and rural housing loans. Since the Agricultural Credit Act of 1987, there have been several amendments to Farmer Mac's chartering statute. Perhaps the most significant amending legislation for Farmer Mac was the Farm Credit System Reform Act of 1996 that transformed Farmer Mac from a guarantor of securities backed by loan pools into a direct purchaser of mortgages, enabling it to form pools to securitize. The 1996 Act increased Farmer Mac's ability to provide liquidity to agricultural mortgage lenders. Since the passage of the 1996 Act, Farmer Mac's program activities and business have increased significantly.

Farmer Mac continues to meet statutory minimum core capital and regulatory risk-based capital requirements. Farmer Mac's total program activity (loans purchased and guaranteed, and AgVantage bonds purchased, and real estate owned) as of September 30, 2003, totaled $5.6 billion. That volume represents growth of 8 percent over program activity at September 30, 2002. Of total program activity, $2.4 billion were on-balance sheet loans and agricultural mortgage-backed securities and $3.2 billion were off-balance sheet obligations. Total assets were $4.2 billion at the close of the third quarter, with non-program investments accounting for $1.6 billion of those assets. Farmer Mac's net income for the first three quarters of 2003 was $20 million, an increase of $1.56 million, or 8.8 percent over the same period in 2002.

International Credit Programs

Seven Federal agencies, the Department of Agriculture (USDA), the Department of Defense, the Department of State, the Department of the Treasury, the Agency for International Development (USAID), the Export-Import Bank, and the Overseas Private Investment Corporation (OPIC), provide direct loans, loan guarantees, and insurance to a variety of foreign private and sovereign borrowers. These programs are intended to level the playing field for U.S. exporters, deliver robust support for U.S. manufactured goods, stabilize international financial markets, and promote sustainable development.

Leveling the Playing Field

Federal export credit programs counter subsidies that foreign governments, largely in Europe and Japan, provide their exporters, usually through export credit agencies (ECAs). The U.S. Government has worked since the 1970's to constrain official credit support through a multilateral agreement in the Organization for Economic Cooperation and Development (OECD). This agreement has significantly constrained direct interest rate subsidies and tied-aid grants. Further negotiations resulted in a multilateral agreement that standardized the fees for sovereign lending across all ECAs beginning in April 1999. Fees for non-sovereign lending, however, continue to vary widely across ECAs and markets, thereby providing implicit subsidies.

The Export-Import Bank attempts to strategically "level the playing field" and to fill gaps in the availability of private export credit. The Export-Import Bank provides export credits, in the form of direct loans or loan guarantees, to U.S. exporters who meet basic eligibility criteria and who request the Bank's assistance. USDA's "GSM" programs similarly help to level the playing field. Like programs of other agricultural exporting nations, GSM programs guarantee payment from countries and entities that want to import U.S. agricultural products but cannot easily obtain credit. The U.S. has been negotiating in the OECD the terms of agricultural export financing, the outcome of which could affect the GSM programs.

Stabilizing International Financial Markets

In today's global economy, the health and prosperity of the American economy depend importantly on the stability of the global financial system and the economic health of our major trading partners. The United States can contribute to orderly exchange arrangements and a stable system of exchange rates by providing resources on a multilateral basis through the IMF (discussed in other sections of the Budget), and through financial support provided by the Exchange Stabilization Fund (ESF).

The ESF may provide "bridge loans" to other countries in times of short-term liquidity problems and financial crises. In the past, "bridge loans" from ESF provided dollars to a country over a short period before the disbursement of an IMF loan to the country. Also, a package of up to $20 billion of medium-term ESF financial support was made available to Mexico during its crisis in 1995. Such support was essential in helping to stabilize Mexican and global financial markets. Mexico paid back its borrowings under this package ahead of schedule in 1997, and the United States earned almost $600 million more in interest than it would have if it dollars had not been lent. There was zero subsidy cost for the United States as defined under credit reform, as the medium-term credit carried interest rates reflecting an appropriate country risk premium.

The United States also expressed a willingness to provide ESF support in response to the financial crises affecting some countries such as South Korea in 1997 and Brazil in 1998. It did not prove necessary to provide an ESF credit facility for Korea, but the United States agreed to guarantee through the ESF up to $5 billion of a $13.2 billion Bank for International Settlements credit facility for Brazil. In the event, the ESF guaranteed $3.3 billion in BIS credits to Brazil and earned $140.3 million in commissions. Such support helped to provide the international confidence needed by these countries to begin the stabilization process.

Using Credit to Promote Sustainable Development

Credit is an important tool in U.S. bilateral assistance to promote sustainable development. USAID's Development Credit Authority (DCA) allows USAID to use a variety of credit tools to support its development activities abroad. This unit encompasses newer DCA activities, such as municipal bond guarantees for local governments in developing countries, as well as USAID's traditional microenterprise and urban environmental credit programs. DCA provides non-sovereign loans and loan guarantees in targeted cases where credit serves more effectively than traditional grant mechanisms to achieve sustainable development. DCA is intended to mobilize host country private capital to finance sustainable development in line with USAID's strategic objectives. Through the use of partial loan guarantees and risk sharing with the private sector, DCA stimulates private-sector lending for financially viable development projects, thereby leveraging host-country capital and strengthening sub-national capital markets in the developing world. While there is clear demand for DCA's facilities in some emerging economies, the utilization rate for these facilities is still very low.

OPIC also supports a mix of development, employment, and export goals by promoting U.S. direct investment in developing countries. OPIC pursues these goals through political risk insurance, direct loans, and guarantee products, which provide finance, as well as associated skills and technology transfers. These programs are intended to create more efficient financial markets, eventually encouraging the private sector to supplant OPIC finance in developing countries. OPIC has also created a number of investment funds that provide equity to local companies with strong development potential.

Ongoing Coordination

International credit programs are coordinated through two groups to ensure consistency in policy design and credit implementation. The Trade Promotion Coordinating Committee (TPCC) works within the Administration to develop a National Export Strategy to make the delivery of trade promotion support more effective and convenient for U.S. exporters.

The Interagency Country Risk Assessment System (ICRAS) standardizes the way in which agencies budget for the cost associated with the risk of international lending. The cost of lending by the agencies is governed by proprietary U.S. government ratings, which correspond to a set of default estimates over a given maturity. The methodology establishes assumptions about default risks in international lending using averages of international sovereign bond market data. The strength of this method is its link to the market and an annual update that adjusts the default estimates to reflect the most recent risks observed in the market.

For 2005, OMB updated the default estimates using the default estimate methodology introduced in FY 2003 and the most recent market data. The 2003 default estimate methodology implemented a significant revision that uses more sophisticated financial analyses and comprehensive market data, and better isolates the expected cost of default implicit in interest rates charged by private investors to sovereign borrowers. All else being equal, this change expands the level of international lending an agency can support with a given appropriation. For example, the Export-Import Bank will be able to generally provide higher lending levels using lower appropriations in 2005.

Adapting to Changing Market Conditions

Overall, officially supported finance and transfers account for a tiny fraction of international capital flows. Furthermore, the private sector is continuously adapting its size and role in emerging markets finance to changing market conditions. In response, the Administration is working to adapt international lending at Export-Import Bank and OPIC to dynamic private sector finance. The Export-Import Bank, for example, is developing a sharper focus on lending that would otherwise not occur without Federal assistance. Measures under development include reducing risks, collecting fees from program users, and improving the focus on exporters who truly cannot access private export finance.

OPIC in the past has focused relatively narrowly on providing financing and insurance services to large U.S. companies investing abroad. As a result, OPIC did not devote significant resources to its mission of promoting development through mobilizing private capital. In 2003, OPIC implemented new development performance measures and goals that reflect the mandate to revitalize its core development mission.

These changes at the Export-Import Bank and at OPIC will place more emphasis on correcting market imperfections as the private sector's ability to bear emerging market risks becomes larger, more sophisticated, and more efficient.

Performance Assessment

For FY 2005, the Administration used the Performance Assessment Rating Tool (PART) to rate OPIC's insurance and finance programs. The PART revealed the insurance program is generally well-managed and that it has instituted a meaningful policy to ensure it does not compete with private insurance companies. The PART found that the finance program could improve its credit function by ensuring the independence of the Credit Committee and the credit review process from the deal originating departments.

IV. INSURANCE PROGRAMS

Deposit Insurance

Federal deposit insurance promotes stability in the U.S. financial system. Prior to the establishment of Federal deposit insurance, failures of some depository institutions often caused depositors to lose confidence in the banking system and rush to withdraw deposits. Such sudden withdrawals caused serious disruption to the economy. In 1933, in the midst of the Depression, the system of Federal deposit insurance was established to protect small depositors and prevent bank failures from causing widespread disruption in financial markets. The federal deposit insurance system came under serious strain in the late 1980s and early 1990s when over 2,500 banks and thrifts failed. The Federal Government responded with a series of reforms designed to improve the safety and soundness of the banking system. These reforms, combined with more favorable economic conditions, helped to restore the health of depository institutions and the deposit insurance system.

The Federal Deposit Insurance Corporation (FDIC) insures deposits in commercial banks and savings associations (thrifts) through separate insurance funds, the Bank Insurance Fund (BIF) and the Savings Association Insurance Fund (SAIF). The National Credit Union Administration (NCUA) administers the insurance fund for most credit unions (certain credit unions are privately insured and not covered by the fund). FDIC and NCUA insure deposits up to $100,000 per account. FDIC insures over $3.4 trillion of deposits at almost 8,000 commercial banks and 1,500 savings institutions. NCUA insures about 9,500 credit unions with $474 billion in insured shares.

Current Industry and Insurance Fund Conditions

Four BIF members with combined assets of $1.2 billion dollars failed during fiscal year 2003, while no SAIF members failed. In the last five years, assets associated with BIF failures have averaged $1.1 billion per year, while failures associated with SAIF averaged $465 million. During 2003, 8 federally insured credit unions with $25 million in assets failed (including assisted mergers). The FDIC currently classifies 116 institutions with $30 billion in assets as "problem institutions," compared to 148 institutions with $42 billion in assets a year ago. By comparison, at the height of the banking crisis in 1989, failed assets rose to over $150 billion.

In the third quarter ending September 30, 2003, banks and thrifts reported record-high earnings. In fiscal year 2003, the industry net income totaled $115 billion, an increase of 13 percent over fiscal year 2002. The largest factor in the earnings increase is higher non-interest income, particularly growth in securitization income and gains on loan sales. Credit quality continues to improve and banks are reporting higher returns on assets. Despite the improving trends, prospects for higher interest rates cause concerns for the industry as increased interest rates usually reduce lending margins.

In fiscal year 2003, the reserve ratio (ratio of insurance reserves to insured deposits) of BIF stayed above the 1.25-percent statutory target. As of September 30, 2003, BIF had estimated reserves of $33 billion, or 1.31 percent of insured deposits. Factors that helped BIF stay above the statutory target in fiscal year 2003 include slower deposit growth, increases in unrealized gains on securities available for sale, and reductions to reserves previously set aside for future estimated losses. In 2003, FDIC developed a new model to estimate the amount of reserves needed for losses after it completed a study that found faults in its current methodology. FDIC continues to refine its new model as it looks to incorporate it in their reserve estimating process. The SAIF reserve ratio remained comfortably above the designated reserve ratio throughout the year. As of September 30, 2003, SAIF had reserves of $12 billion, or 1.40 percent of insured deposits. Through June 30, 2004, the FDIC will continue to maintain deposit insurance premiums in a range from zero for the healthiest institutions to 27 cents per $100 of assessable deposits for the riskiest institutions. In May, the FDIC will set assessment rates for July through December of this year. Due to the strong financial condition of the industry and the insurance funds, less than 10 percent of banks and thrifts paid insurance premiums in 2003.

The National Credit Union Share Insurance Fund (NCUSIF) ended fiscal year 2003 with assets of over $6 billion and an equity ratio of 1.28 percent, below the NCUA-set target ratio of 1.30 percent. Each insured credit union is required to deposit and maintain an amount equal to 1 percent of its member share accounts in the fund. Premiums were waived during 2003 because sufficient investment income was generated. As the Fund's equity ratio did not exceed 1.30 percent, NCUA did not provide a dividend to credit unions in fiscal year 2003.

As a result of consolidation, fewer large banks control an increasingly substantial share of banking assets. Thus, the failure of even one of these large institutions could strain the insurance fund. Banks are increasingly using sophisticated financial instruments such as asset-backed securities and financial derivatives, which could have unforeseen effects on risk levels. Whether or not these new instruments add to risk, they do complicate the work of regulators who must gauge each institution's financial health and the potential for deposit insurance losses that a troubled institution may represent.

Federal Deposit Insurance Reform

While the deposit insurance system is in good condition, the Administration supports reforms to make improvements in the operation and fairness of the deposit insurance system for banks and thrifts. In 2003, the Treasury Department and federal banking regulatory agencies submitted to the U.S. Senate a draft bill that would accomplish this objective. Specifically, the proposal would merge the BIF and the SAIF, which offer an identical product. A single merged fund would be stronger and better diversified than either fund alone. A merged fund would prevent the possibility that institutions posing similar risks would pay significantly different premiums for the same product. Under the current system, the FDIC is required to maintain a ratio of insurance fund reserves to total insured deposits of 1.25 percent. If insurance fund reserves fall below the required ratio, the FDIC must charge either sufficient premiums to restore the reserve ratio to 1.25 percent within one year, or no less than 23 basis points if the reserve ratio remains below 1.25 percent for more than one year. The Administration's proposal would give the FDIC authority to adjust the ratio periodically within prescribed upper and lower bounds and greater discretion in determining how quickly it restores the ratio to target levels. This flexibility would help the banking industry to stabilize the premium costs over time and to avoid sharp premium increases when the economy might be under stress. Finally, the FDIC has been prohibited since 1996 from charging premiums to "well-capitalized" and well-run institutions as long as insurance fund reserves equal or exceed 1.25 percent of insured deposits. Therefore, less than 10 percent of banks and thrifts pay insurance premiums, allowing a large number of financial institutions to rapidly increase their insured deposits without any contribution to the insurance fund. The Administration proposal would repeal this prohibition to ensure that institutions with rapidly increasing insured deposits or greater risks appropriately compensate the insurance fund.

Pension Guarantees

The Pension Benefit Guaranty Corporation (PBGC) insures most defined-benefit pension plans sponsored by private employers. PBGC pays the benefits guaranteed by law when a company with an underfunded pension plan becomes insolvent. PBGC's exposure to claims relates to the underfunding of pension plans, that is, to any amount by which vested future benefits exceed plan assets. In the near term, its loss exposure results from financially distressed firms with underfunded plans. In the longer term, additional loss exposure results from the possibility that currently healthy firms become distressed and currently well-funded plans become underfunded due to inadequate contributions or poor investment results.

PBGC monitors troubled companies with underfunded plans and acts, in bankruptcies, to protect its beneficiaries and the future of the program. Such protections include, where necessary, initiating plan termination. Under its Early Warning Program, PBGC negotiates settlements with companies that improve pension security and reduce PBGC's future exposure to risk.

PBGC's single-employer program ended 2002 at a deficit of $3.6 billion, which deepened in 2003 to about $11.3 billion. The deficit has resulted from record losses on plan terminations in 2001 through 2003. In 2002 LTV, a steel company, terminated its plan with underfunding of nearly $2 billion, which then was PBGC's largest claim ever. But in December 2002, an even larger pension plan terminated. Bethlehem Steel's plan covered 95,000 workers and retirees and was underfunded by about $4.3 billion, of which PBGC is liable for about $3.6 billion. Other large underfunded terminations in 2003 included Columbia Hospital for Women, Consolidated Freightways, Geneva Steel, Hawaii Baking Company, National Steel, and US Airways' Pilots Plan. Since year's end, PBGC has terminated Kaiser Aluminum Salaried Plan, Pillowtex, and Weirton Steel.

Moreover this "snapshot" measure of PBGC's deficit could hide significant risk of further losses. It includes the financial effects only of pension plans that have already terminated and of seriously underfunded large plans for which termination is considered "probable." Additional risk and exposure may remain for the future because of economic uncertainties and significant underfunding in single-employer pension plans, which exceeded an estimated $350 billion at year end, compared to $50 billion in December 2000. Some of the companies with the most underfunded plans are in financially troubled industries (like airlines or the old-line steel companies), or are already in Chapter 11 bankruptcy proceedings.

The smaller multiemployer program guarantees pension benefits of certain unionized plans offered by several employers in an industry. It ended 2003 with its first deficit in over 20 years, of about $261 million. Underfunding in multiemployer plans approximated $100 billion at year end.

PBGC is not in crisis—the agency has sufficient assets to meet its obligations for a number of years into the future—but it is clear that the financial integrity of the federal pension insurance system is at risk.

Looking to the long term, in order to avoid benefit reductions, strengthen PBGC, and help stabilize the defined-benefit pension system, the 2005 Budget proposes legislative reforms to:

- Give employers two years of relief from current pension plan contribution requirements—now tied to 30-year Treasury bond interest rates—and base requirements on more appropriate corporate bond rates.
- After the two-year transition period, base pension funding requirements on a "yield curve" (commonly used in corporate finance), which would better tie funding requirements to the timing of the payout of retiree benefits.
- Make additional changes to restrict promises of added benefits by severely underfunded plans and to provide better information on pension finances to workers, retirees, and stockholders.

Additionally, the Administration is developing a plan for comprehensive reform of the pension funding rules to: strengthen funding for workers' defined-benefit pensions; simplify funding rules; offer sponsors new, flexible approaches to finance their plans without the present yearly volatility; and make additional reforms to ensure PBGC's continued ability to safeguard pension benefits.

Disaster Insurance

Flood Insurance

The Federal Government provides flood insurance through the National Flood Insurance Program (NFIP), which is administered by the Emergency Preparedness and Response Directorate of the Department of Homeland Security (DHS). Flood insurance is available to homeowners and businesses in communities that have adopted and enforced appropriate flood plain management measures. Coverage is limited to buildings and their contents. By 2005, the program is projected to have approximately 4.7 million policies from more than 19,000 communities with $699 billion of insurance in force.

Prior to the creation of the program in 1968, many factors made it cost prohibitive for private insurance companies alone to make affordable flood insurance available. In response, the NFIP was established to make insurance coverage widely available. The NFIP requires building standards and other mitigation efforts to reduce losses, and operates a flood hazard mapping program to quantify the geographic risk of flooding. These efforts have made substantial progress.

The number of policies in the program has grown significantly over time. The number of enrolled policies grew from 2.4 to 4.3 million between 1990 and 2002, and by about 34,000 policies in 2003. DHS is using three strategies to increase the number of flood insurance policies in force: lender compliance, program simplification, and expanded marketing. DHS is educating financial regulators about the mandatory flood insurance requirement for properties with mortgages from federally regulated lenders. The NFIP also has a multi-pronged strategy for reducing future flood damage. The NFIP offers mitigation insurance to allow flood victims to rebuild to code, thereby reducing future flood damage costs. Further, through the Community Rating System, DHS adjusts premium rates to encourage community and State mitigation activities beyond those required by the NFIP.

Despite these efforts, the program faces financial challenges. The program's financing account, which is a cash fund, has sometimes had expenses greater than its revenue, preventing it from building sufficient long-term reserves. This is mostly because a large portion of the policyholders pay subsidized premiums. DHS charges subsidized premiums for properties built before a community adopted the NFIP building standards. Properties built subsequently are charged actuarially fair rates. The creators of the NFIP assumed that eventually the NFIP would become self-sustaining as older properties left the program. The share of subsidized properties in the program has fallen, but remains substantial; it was 70 percent in 1978 and is 28 percent today.

Until the mid-1980s, Congress appropriated funds periodically to support subsidized premiums. However, the program has not received appropriations since 1986. During the 1990s, FEMA, which is now part of DHS, relied on Treasury borrowing to help finance its loss expenses (the NFIP may borrow up to $1.5 billion). As of October 31, 2002, the NFIP had repaid all of its outstanding debt.

Although the program is generally well run, it receives some criticism about the low participation rate and the inclusion of subsidized properties, especially those that are repetitively flooded. The program has identified approximately 11,000 properties for mitigation action. To the extent they are available; funds will come from the Hazard Mitigation Grant Program, the Predisaster Mitigation Grant Program, and the Flood Mitigation Grant Program. There is also current legislation pending to address the problem of repetitive loss properties. An additional problem is the fairly low participation rate. Currently, less than half of the eligible properties in identified flood plains participate in this program. In comparison, the participation rate for private wind and hurricane insurance is nearly 90 percent in at-risk areas. Given that flood damage causes roughly $6 billion in property damage annually, DHS will have to evaluate its incentive structure to attract more participation in the program, while not encouraging misuse of the program.

Crop Insurance

Subsidized Federal crop insurance administered by USDA's Risk Management Agency (RMA) plays an important role in assisting farmers to manage yield and revenue shortfalls due to bad weather or other natural disasters. RMA continues to evaluate and, as appropriate, provide new products so that the Government can further reduce the need for ad-hoc disaster assistance payments to the agriculture community in bad years.

The USDA crop insurance program is a cooperative effort between the Federal Government and the private insurance industry. Private insurance companies sell and service crop insurance policies. These companies rely to varying degrees on reinsurance provided by the Federal Government and the commercial reinsurance market to manage their individual risk portfolio. The Federal Government also reimburses private companies for the administrative expenses associated with providing crop insurance and reinsures the private companies for excess insurance losses on all policies. The Federal Government also subsidizes premiums for farmers. In crop year 2003, 215 million acres were insured, with an estimated $3.4 billion in total premiums collected, including $2 billion in premium subsidy.

During FY 2004 RMA will be renegotiating the Standard Reinsurance Agreement (SRA). The SRA contains the operational and financial risk sharing terms between the Federal government and the private companies. The Agriculture Risk Protection Act of 2000 (ARPA) allowed these terms to be renegotiated once during the 2001 and 2005 reinsurance years. RMA is taking this opportunity to strengthen the document now to address such issues as company oversight and quality control. In addition, significant attention will be given to evaluating all the financial incentives, risk sharing scenarios and administrative cost reimbursement percentages to ensure that the companies and the Federal government are bearing an appropriate amount of the costs associated with the crop insurance program. RMA is seeking to finalize the new SRA by June of 2004.

There are various types of insurance programs. The most basic type of coverage is Catastrophic Crop Insurance (CAT), which compensates the farmer for losses up to 50 percent of the individual's average yield at 55 percent of the expected market price. The CAT premium is entirely subsidized, and farmers pay only a small administrative fee. Commercial insurance companies deliver the product to the producer in all states. Additional coverage is available to producers who wish to insure crops above the basic coverage. Premium rates for additional coverage depend on the level of coverage selected and vary from crop to crop and county to county. The additional levels of insurance coverage are more attractive to farmers due to availability of optional units, other policy provisions not available with CAT coverage, and the ability to obtain a level of protection that permits them to use crop insurance as loan collateral and to achieve greater financial security. Private companies sell and service the catastrophic portion of the crop insurance program, and also provide higher levels of coverage, which are also federally subsidized. Approximately 80 percent of eligible acres participated in one or more crop insurance programs in 2003.

There are also a wide range of yield and revenue-based insurance products are available through the crop insurance program. Revenue insurance programs protect against loss of revenue stemming from low prices, poor yields, or a combination of both. These programs extend traditional multi-peril crop insurance protection by adding price variability to production history. Indemnities are due when any combination of yield and price results in revenue that is less than the revenue guarantee. The price component common to these plans uses the commodity futures market for price discovery.

USDA also continues to expand coverage. In September 2001, RMA published an interim rule that allows RMA to reimburse developers of private crop insurance products for their research and development costs and maintenance costs.

Two pilot insurance programs for Iowa swine producers to protect them from lower hog prices began in 2002. The Livestock Gross Margin (LGM) and the Livestock Risk Protection (LRP). The LRP program was expanded in August 2003 to 10 additional states.

In April 2003, RMA announced two pilot programs that will extend insurance protection to fed and feeder cattle. They are designed to insure against declining market prices. Both offer coverage prices based on expected cash prices. The Federal Crop Insurance Corporation (FCIC) will subsidize 13 percent of the producer's gross premium under both programs. LRP-Feeder Cattle is available in 10 states. LRP-Fed Cattle is available to producers in three states.

For more information and additional crop insurance program details, please reference RMA's web site: (*www.rma.usda.gov*).

Insurance against Security-Related Risks

The Federal Government offers terrorism risk insurance and Airline War Risk Insurance on a temporary basis, and has created the smallpox injury compensation program. After the September 11 attacks, private insurers became reluctant to insure against security-related risks such as terrorism and war. Those events are so uncertain in terms of both the frequency of occurrence and the magnitude of potential loss that private insurers have difficulty estimating the expected loss. Furthermore, terrorism can produce a large loss that could wipe out private insurers' capital. These uncertainties make the private sector reluctant to provide security-related insurance. Thus, it is necessary for the Federal Government to insure against security-related risks, until the private sector learns enough to be comfortable about estimating those risks, to ensure the smooth functioning of the economy.

Terrorism Risk Insurance

On November 26, 2002, President Bush signed into law the Terrorism Risk Insurance Act of 2002. The Act was designed to address disruptions in economic activity caused by the withdrawal of many insurance companies from the marketplace for terrorism risk insurance in the aftermath of the terrorist attacks of September 11, 2001. Their withdrawal in the face of great uncertainty as to their risk exposure to future terrorist attacks led to a moratorium in construction projects, increased business costs for the insurance that was available, and substantial shifting of risk—from reinsurers to primary insurers, and from insurers to policyholders (e.g., investors, businesses, and property owners). Ultimately, these costs were borne by American workers and communities through decreased development and economic activity.

The Act establishes a temporary Federal program that provides for a system of shared public and private compensation for insured commercial property and casualty losses arising from acts of terrorism. The program is administered by the Treasury Department and will sunset on December 31, 2005.

Under the Act, insurance companies included under the program must make available to their policyholders during the first two years of the program coverage for losses from acts of terrorism (as defined by the Act), and Treasury is required to determine whether to extend this requirement into the third and final year of the program. The Act also requires as a condition for Federal payment that insurance companies disclose to policyholders the premium charged for terrorism risk insurance and the Federal share of compensation under the program.

In the event of a future terrorist attack on private businesses and others covered by this program, insurance companies will cover insured losses up to each company's deductible as specified in the Act. Insured losses above that amount in a given year would be shared between the insurance company and the Treasury, with Treasury covering 90 percent of the losses above the company's deductible. However, neither the Treasury nor any insurer would be liable for any amount exceeding the statutory annual cap of $100 billion in aggregate insured losses. The Act also provides authority for the Treasury to recoup Federal payments via surcharges on policyholders. In some circumstances this recoupment is mandatory, in other circumstances, as specified in the Act, its exercise is optional.

Promptly after the Act was signed into law, Treasury issued a number of interim guidance notices to assist the insurance industry in complying with the requirements of the Act. The interim guidance notices were directly followed by the issuance of formal regulations to implement the Act. Treasury has also created a separate Terrorism Risk Insurance Program office to implement the Act, which includes setting up an infrastructure to handle potential claims under the Act.

Airline War Risk Insurance

After the September 11, 2001 attacks, private insurers cancelled third party liability war risk coverage for airlines and dramatically increased the cost of other war risk insurance. In response, the Department of Transportation (DOT) provided a short-term reimbursement to airlines for the increased cost of aviation hull and passenger liability war risk insurance under the authority provided in P.L. 107–42. Under Presidential Determination No. 01–29, the President delegated the authority to extend the duration of aviation insurance to the Secretary of Transportation. Due to the extended disruption in the marketplace, DOT also offered airlines third-party liability war risk insurance coverage at subsidized rates to replace coverage initially withdrawn by private insurers. DOT has continued to provide insurance coverage in 60-day increments since 2001.

The Homeland Security Act of 2002 included airline war risk insurance legislation. This law extended the term of third party war risk coverage and expanded the scope of coverage to include war risk hull, passenger, crew, and property liability insurance. Under the law, the Secretary of Transportation was directed to extend insurance policies until August 31, 2003. In addition, the law also limited the total premium for the three types of insurance to twice the premium rate charged for the third party liability insurance as of June 19, 2002. In 2003 the Department of Defense supplemental appropriation further extended the mandatory provision of insurance through August 31, 2004. Consequently, in December 2003 the President issued Presidential Determination 2004–13 which authorizes the continued provision of insurance now in force through August 31, 2004 and the DOT expects to amend current policies to conform to that date. Recently, the basic authority of the insurance program was extended through December 31, 2008 by P.L. 108–176, Vision 100—Century of Aviation Reauthorization Act.

Currently 76 air carriers are insured by DOT. Coverage for individual carriers ranges from $80 million to $4 billion per carrier with the median insurance coverage at approximately $1.8 billion per occurrence. Premiums collected by the Government are deposited into the Aviation Insurance Revolving Fund. In FY 2003, the fund collected approximately $136 million in premiums for insurance provided by DOT. In FY 2004, it is anticipated that up to $125 million in premiums may be collected by DOT for the provision of insurance. At the end of FY 2003, the balance of the Aviation Insurance Revolving Fund used to pay claims was $218 million. Any claims by the airlines that exceed the balance in the aviation insurance revolving fund would be paid by the Federal Government.

Smallpox Injury Compensation

The Administration has taken steps to insure the immediate mobilization of emergency response personnel in the event of a smallpox attack. The Smallpox Injury Compensation Program, set up under the Smallpox Emergency Personnel Protection Act of 2003, encourages vaccination of designated emergency personnel by providing benefits and/or compensation to certain persons harmed as a direct result of receiving smallpox countermeasures, including the smallpox vaccine. Only persons receiving the smallpox vaccine under the Department of Health and Human Services Declaration Regarding the Administration of Smallpox Countermeasures are eligible for benefits. Also, the Homeland Security Act of 2002 provided medical liability protection to doctors, drug manufacturers, and hospitals that administer smallpox vaccine and other countermeasures during an emergency declaration.

Chart 7-1. Face Value of Federal Credit Outstanding

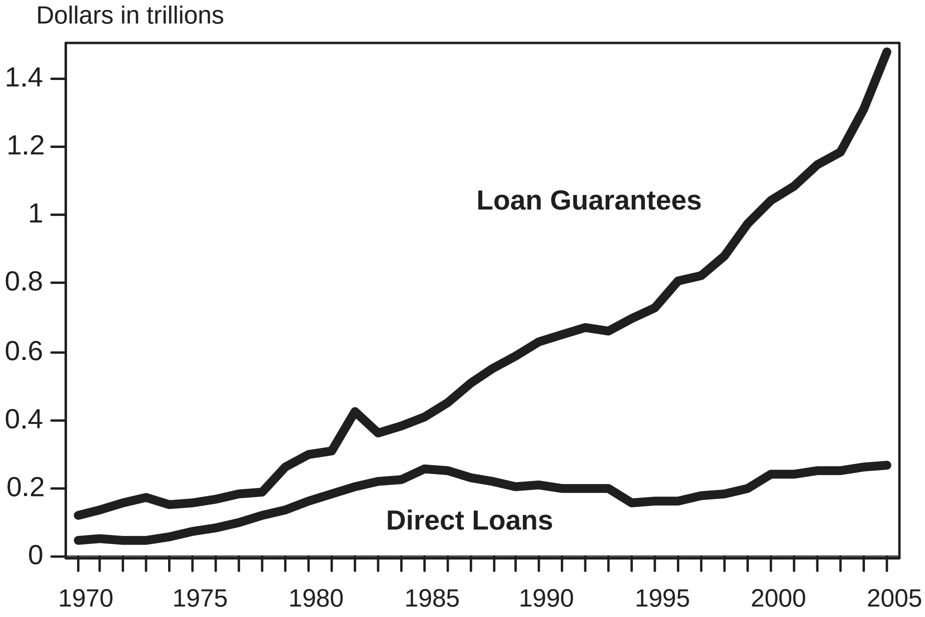


Table 7–1. ESTIMATED FUTURE COST OF OUTSTANDING FEDERAL CREDIT PROGRAMS

(in billions of dollars)

Program	Outstanding 2002	Estimated Future Costs of 2002 Outstanding[1]	Outstanding 2003	Estimated Future Costs of 2003 Outstanding[1]
Direct Loans[2]				
Federal Student Loan Programs	99	14	102	10
Farm Service Agency (excl.CCC), Rural Development, Rural Housing	45	11	44	11
Rural Utilities Service and Rural Telephone Bank	32	2	32	3
Housing and Urban Development	12	2	13	3
Agency for International Development	9	7	9	4
Public Law 480	11	2	11	7
Export-Import Bank	12	4	11	4
Commodity Credit Corporation	5	3	7	3
Federal Communications Commission	5	*	5	1
Disaster Assistance	4	*	3	1
Other Direct Loan Programs	14	*	12	*
Total Direct Loans	248	45	249	47
Guaranteed Loans:[2]				
FHA Mutual Mortgage Insurance Fund	467	3	407	2
VA Mortgage	265	6	323	5
Federal Family Education Loan Program	182	12	213	15
FHA General/Special Risk Insurance Fund	96	5	89	4
Small Business	41	1	53	2
Export-Import Bank	31	5	34	3
International Assistance	19	2	19	2
Farm Service Agency and Rural Housing	23	*	24	1
Commodity Credit Corporation	5	1	4	*
Other Guaranteed Loan Programs	17	2	18	2
Total Guaranteed Loans	1,146	37	1,184	36
Total Federal Credit	**1,394**	**82**	**1,433**	**83**

* Less than $500 million.

[1] Direct loan future costs are the financing account allowance for subsidy cost and the liquidating account allowance for estimated uncollectible principal and interest. Loan guarantee future costs are estimated liabilities for loan guarantees.

[2] Excludes loans and guarantees by deposit insurance agencies and programs not included under credit reform, such as CCC commodity price supports. Defaulted guaranteed loans which become loans receivable are accounted for as direct loans.

Table 7–2. REESTIMATES OF CREDIT SUBSIDIES ON LOANS DISBURSED BETWEEN 1992–2003 [1]

(Budget authority and outlays, in millions of dollars)

Program	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
DIRECT LOANS:											
Agriculture:											
Agriculture credit insurance fund	–72	28	2	–31	23	....	331	–656	921	10	–701
Farm storage facility loans	....	....	....	....	....	....	....	....	–1	–7	–8
Apple loans	....	....	....	....	....	....	....	....	–2	1	....
Emergency boll weevil loan	....	....	....	....	....	....	....	....	....	1	*
Agricultural conservation	–1	....	....	....	....	....	....	....	....	....	....
Distance learning and telemedicine	....	....	....	....	....	....	....	....	1	–1	....
Rural electrification and telecommunications loans	*	61	–37	84	....	–39	....	–17	–42	101	....
Rural telephone bank	1	....	....	10	....	–9	....	–1	....	–3	–7
Rural housing insurance fund	2	152	46	–73	....	71	....	19	–29	–435	....
Rural economic development loans	....	....	....	1	....	–1	*	....	–1	–1	....
Rural development loan program	....	1	....	....	....	–6	....	....	–1	–3	....
Rural community advancement program [2]	....	....	....	8	....	5	....	37	3	–1	....
P.L. 480	....	....	–37	–1	....	....	....	–23	65	–348	33
P.L. 480 Title I food for progress credits	....	84	–38	....	....	....	....	....	....	–112	–44
Commerce:											
Fisheries finance	....	....	....	....	....	....	....	–19	–1	–3	1
Defense:											
Military housing improvement fund	....	....	....	....	....	....	....	....	....	....	–1
Education:											
Federal direct student loan program: [3]											
Volume reestimate	....	....	....	....	....	22	....	–6	....	43	....
Other technical reestimate	....	....	3	–83	172	–383	–2,158	560	....	3,678	2,005
College housing and academic facilities loans	....	....	....	....	....	....	....	–1	....	....	....
Homeland Security:											
Disaster assistance	....	....	....	....	....	....	47	36	–7	–6	*
Interior:											
Bureau of Reclamation loans	....	....	....	....	....	....	3	3	–9	–14	....
Bureau of Indian Affairs direct loans	....	....	....	....	....	1	5	–1	–1	2	*
Assistance to American Samoa	....	....	....	....	....	....	....	....	....	....	*
Transportation:											
High priority corridor loans	....	....	....	....	–3	....	....	....	....	....	....
Alameda corridor loan	....	....	....	....	....	....	–58	....	....	....	–50
Transportation infrastructure finance and innovation	....	....	....	....	....	....	....	18	....	....	–4
Railroad rehabilitation and improvement program	....	....	....	....	....	....	....	....	....	....	–5
Treasury:											
Community development financial institutions fund	....	....	....	....	....	....	1	....	....	*	–2
Veterans Affairs:											
Veterans housing benefit program fund	–39	30	76	–72	465	–111	–52	–107	–697	17	–178
Native American veteran housing	....	....	....	....	....	....	....	....	....	–3	*
Vocational rehabilitation loans	....	....	....	....	....	....	....	....	....	*	*
Environmental Protection Agency:											
Abatement, control and compliance	....	....	....	....	....	....	....	3	–1	*	–3
General Services Administration:											
Columbia hospital for women	....	....	....	....	....	....	....	....	–6	....	....
International Assistance Programs:											
Foreign military financing	....	....	....	13	4	1	152	–166	119	–397	–64
U.S. Agency for International Development:											
Micro and small enterprise development	....	....	....	....	....	....	....	....	*	....	*
Overseas Private Investment Corporation:											
OPIC direct loans	....	....	....	....	....	....	....	....	....	–4	–21
Debt reduction	....	....	....	....	....	....	36	–4	....	*	–48
Small Business Administration:											
Business loans	....	....	....	....	....	....	....	1	–2	1	....
Disaster loans	....	....	....	....	–193	246	–398	–282	–14	266	624
Other Independent Agencies:											
Export-Import Bank direct loans	–28	–16	37	....	....	....	–177	157	117	–640	–353
Federal Communications Commission spectrum auction	....	....	....	....	4,592	980	–1,501	–804	92	346	380

Table 7–2. REESTIMATES OF CREDIT SUBSIDIES ON LOANS DISBURSED BETWEEN 1992–2003 [1]—Continued

(Budget authority and outlays, in millions of dollars)

Program	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
LOAN GUARANTEES:											
Agriculture:											
Agriculture credit insurance fund	5	14	12	–51	96	....	–31	205	40	–36	–32
Agriculture resource conservation demonstration project	....	....	....	....	....	....	....	2	....	1	*
Commodity Credit Corporation export guarantees	3	103	–426	343	....	....	....	–1,410	....	–13	–431
Rural development insurance fund	49	....	....	–3	....	....	....	....	....	....	....
Rural housing insurance fund	2	10	7	–10	....	109	....	152	–56	32	....
Rural community advancement program [2]	....	....	....	–10	....	41	....	63	17	91	....
Commerce:											
Fisheries finance	....	....	....	....	–2	....	....	–3	–1	3	*
Emergency steel guaranteed loans	....	....	....	....	....	....	....	....	....	50	*
Emergency oil and gas guaranteed loans	....	....	....	....	....	....	....	*	*	*	*
Defense:											
Military housing improvement fund	....	....	....	....	....	....	....	....	....	....	–2
Defense export loan guarantee	....	....	....	....	....	....	....	....	....	....	–4
Education:											
Federal family education loan program: [3]											
Volume reestimate	....	....	535	99	....	–13	–60	–42	....	277	....
Other technical reestimate	97	421	60	....	....	–140	667	–3,484	....	–2,483	–3,278
Health and Human Services:											
Heath center loan guarantees	....	....	....	....	....	....	3	....	*	*	*
Health education assistance loans	....	....	....	....	....	....	....	....	....	–5	–37
Housing and Urban Development:											
Indian housing loan guarantee	....	....	....	....	....	....	....	–6	*	–1	*
Title VI Indian guarantees	....	....	....	....	....	....	....	....	....	–1	1
Community development loan guarantees	....	....	....	....	....	....	....	....	....	....	19
FHA-mutual mortgage insurance	....	....	....	–340	....	3,789	....	2,413	–1,308	1,100	5,947
FHA-general and special risk	–175	....	–110	–25	743	79	....	–217	–403	77	351
Interior:											
Bureau of Indian Affairs guaranteed loans	....	....	....	31	....	....	....	–14	–1	–2	–1
Transportation:											
Maritime guaranteed loans (title XI)	....	....	....	....	....	–71	30	–15	187	27	–16
Minority business resource center	....	....	....	....	....	....	....	....	1	....	*
Treasury:											
Air transportation stabilization program	....	....	....	....	....	....	....	....	....	113	–199
Veterans Affairs:											
Veterans housing benefit fund program	–447	167	334	–706	38	492	229	–770	–163	–184	–1,547
International Assistance Programs:											
U.S. Agency for International Development:											
Development credit authority	....	....	....	....	....	....	....	....	–1	....	*
Micro and small enterprise development	....	....	....	....	....	....	....	....	....	....	4
Urban and environmental credit	–2	–1	–7	....	–14	....	....	....	–4	–15	48
Assistance to the new independent states of the former Soviet Union [4]	....	....	....	....	....	....	....	....	–34	....	....
Loan guarantees to Israel	....	....	....	....	....	....	....	....	....	....	–76
Overseas Private Investment Corporation:											
OPIC guaranteed loans	....	....	....	....	....	....	....	....	5	77	60
Small Business Administration:											
Business loans	....	....	257	–16	–279	–545	–235	–528	–226	304	1,750
Other Independent Agencies:											
Export-Import Bank guarantees	–11	–59	13	....	....	....	–191	–1,520	–417	–2,042	–1,031
Total	**–616**	**995**	**727**	**–832**	**5,642**	**4,518**	**–3,641**	**–6,427**	**–1,860**	**–142**	**3,083**

* Less than $500,000.

[1] Excludes interest on reestimates. Additional information on credit reform subsidy rates is contained in the Federal Credit Supplement.

[2] Includes rural water and waste disposal, rural community facilities, and rural business and industry programs.

[3] Volume reestimates in mandatory loan guarantee programs represent a change in volume of loans disbursed in the prior years. These estimates are the result of guarantee programs where data from loan issuers on actual disbursements of loans are not received until after the close of the fiscal year.

[4] Closing reestimate executed in fiscal year 2002.

Table 7–3. DIRECT LOAN SUBSIDY RATES, BUDGET AUTHORITY, AND LOAN LEVELS, 2003–2005

(in millions of dollars)

Agency and Program	2003 Actual			2004 Enacted			2005 Proposed		
	Subsidy rate [1]	Subsidy budget authority	Loan levels	Subsidy rate [1]	Subsidy budget authority	Loan levels	Subsidy rate [1]	Subsidy budget authority	Loan levels
Agriculture:									
Agricultural credit insurance fund	14.71	155	1,054	13.10	109	832	8.11	74	912
Farm storage facility loans	1.28	2	147	0.46	....	82	–2.44	–2	82
Rural community advancement program	10.00	104	1,040	1.96	30	1,532	7.85	102	1,300
Rural electrification and telecommunications loans	–0.85	–38	4,454	–1.73	–76	4,404	–1.15	–35	3,035
Rural telephone bank	1.38	2	168	–4.32	–7	174	....	....	....
Distance learning, telemedicine, and broadband program	1.30	1	77	2.30	49	2,131	2.75	8	291
Farm labor	49.02	30	61	42.73	18	42	47.06	20	42
Rural housing insurance fund	22.47	269	1,197	12.11	184	1,520	13.48	164	1,217
Rural development loan fund	48.26	19	40	43.27	17	40	46.38	16	34
Rural economic development loans	21.36	3	15	18.61	3	15	18.79	5	25
Public law 480 title I	62.84	51	81	78.90	30	38	86.42	26	30
Commerce:									
Fisheries finance	–5.52	–8	145	–2.44	–4	164	–13.33	–4	30
Defense—Military:									
Family housing improvement fund	21.71	28	129	69.23	153	221	34.22	181	529
Education:									
College housing and academic facilities loans	....	....	269	....	....	269	....	....	170
Federal direct student loan program	–1.50	–318	21,205	–1.19	–250	21,013	–2.93	–648	22,287
Homeland Security:									
Disaster assistance direct loan	–4.10	–1	25	–2.02	–1	25	–2.60	–1	25
Housing and Urban Development:									
FHA-mutual mortgage insurance	....	....	50	....	....	50	....	....	50
FHA-general and special risk	....	....	50	....	....	50	....	....	50
State:									
Repatriation loans	80.00	1	1	70.75	1	1	69.73	1	1
Transportation:									
Federal-aid highways	7.10	10	140	5.96	127	2,400	5.94	131	2,400
Treasury:									
Community development financial institutions fund	32.85	1	4	34.37	4	11	36.52	4	11
Veterans Affairs:									
Vocational rehabilitation and employment administration	1.50	....	3	1.33	....	4	1.14	....	4
Housing	–1.54	–7	566	–0.44	–5	1,135	–4.49	–77	1,715
International Assistance Programs:									
Foreign military financing loan	....	....	3,800	–0.05	....	550	....	....	....
Debt restructuring	....	211	....	....	59	....	....	105	....
Overseas Private Investment Corporation	4.97	20	394	16.78	24	143	17.12	19	111
Small Business Administration:									
Disaster loans	15.21	117	769	11.72	56	758	12.86	79	614
Business loans	13.05	4	29	9.55	2	20	10.25	....	....
Export-Import Bank of the United States:									
Export-Import Bank loans	1.72	1	58	34.00	17	50	34.00	17	50
Total	**N/A**	**657**	**35,971**	**N/A**	**540**	**37,674**	**N/A**	**185**	**35,015**

N/A = Not applicable.

[1] Additional information on credit subsidy rates is contained in the Federal Credit Supplement.

Table 7–4. LOAN GUARANTEE SUBSIDY RATES, BUDGET AUTHORITY, AND LOAN LEVELS, 2003–2005

(in millions of dollars)

Agency and Program	2003 Actual			2004 Enacted			2005 Proposed		
	Subsidy rate [1]	Subsidy budget authority	Loan levels	Subsidy rate [1]	Subsidy budget authority	Loan levels	Subsidy rate [1]	Subsidy budget authority	Loan levels
Agriculture:									
Agricultural credit insurance fund	3.38	90	2,662	3.27	79	2,416	2.83	81	2,866
Commodity Credit Corporation export loans	4.10	170	4,146	6.96	289	4,155	6.82	309	4,528
Rural community advancement program	3.28	35	1,067	2.99	25	837	3.28	29	885
Rural electrification and telecommunications loans	0.08	....	....	0.06	....	99	0.06	....	100
Distance learning, telemedicine, and broadband program	....	....	....	3.75	3	80	5.00	2	40
Local television loan guarantee	....	....	....	8.46	44	520	....	....	....
Rural housing insurance fund	1.22	39	3,186	1.64	46	2,808	1.31	37	2,825
Rural business investment	20.00	....	....	20.00	....	....	20.00	....	....
Commerce:									
Emergency steel guaranteed loan	27.69	69	250	....	....	....	....	....	....
Defense—Military:									
Procurement of ammunition, Army	3.34	1	17	3.38	1	16	....	....	....
Family housing improvement fund	3.70	7	189	1.54	4	259	9.65	14	145
Education:									
Federal family education loan	9.57	6,411	66,976	9.19	6,501	70,760	9.47	7,050	71,349
Health and Human Services:									
Health education assistance loans	15.76	16	100	16.48	25	150	....	....	....
Health resources and services	3.65	1	4	4.68	1	17	5.64	1	17
Housing and Urban Development:									
Indian housing loan guarantee fund	2.43	5	197	2.73	5	197	2.58	1	29
Native Hawaiian housing loan guarantee fund	2.43	1	40	2.73	1	40	2.58	1	37
Native American housing block grant	11.07	2	17	10.56	2	18	10.32	2	18
Community development loan guarantees	2.30	6	275	2.30	6	275	....	....	....
FHA-mutual mortgage insurance	–2.53	–3,584	165,000	–2.47	–3,545	185,000	–1.73	–2,627	185,000
FHA-general and special risk	–1.02	–254	25,000	–1.17	–293	25,000	–0.69	–242	35,000
Interior:									
Indian guaranteed loan	6.91	5	72	6.13	5	84	6.76	5	86
Transportation:									
Minority business resource center program	2.69	....	9	2.53	....	18	2.08	1	18
Federal-aid highways	....	....	....	4.77	10	200	4.68	9	200
Maritime guaranteed loan (title XI)	6.09	21	345	6.10	25	410	6.76	25	370
Treasury:									
Air transportation stabilization [2]	13.70	180	1,276	–8.93	–3	30	....	....	....
Veterans Affairs:									
Veterans housing benefit program	0.83	547	66,074	0.58	275	47,312	–0.21	–86	41,829
International Assistance Programs:									
Loan guarantees to Israel	....	....	1,600	....	....	3,460	....	....	3,650
Development credit authority	6.44	18	280	3.11	21	675	4.31	21	487
Overseas Private Investment Corporation	–8.01	–57	712	1.81	5	276	0.49	3	615
Small Business Administration:									
Business loans	0.77	118	15,318	0.38	79	20,986	....	....	29,000
Export-Import Bank of the United States:									
Export-Import Bank loans	3.06	320	10,449	3.03	349	11,507	3.94	474	11,976
Presidio Trust:									
Presidio Trust	....	....	....	0.14	....	200	0.05	....	....
Total	**N/A**	**4,167**	**365,261**	**N/A**	**3,960**	**377,805**	**N/A**	**5,110**	**391,070**
ADDENDUM: SECONDARY GUARANTEED LOAN COMMITMENT LIMITATIONS									
GNMA:									
Guarantees of mortgage-backed securities loan guarantee	–0.33	–398	252,870	–0.27	–405	200,000	–0.23	–368	200,000

N/A = Not applicable.

[1] Additional information on credit subsidy rates is contained in the Federal Credit Supplement.

[2] Numbers shown for 2004 include estimates for loan guarantees that have received either conditional or final approval. This presentation should not be construed as prejudging the outcome of the Air Transportation Stabilization Board's deliberations. The Board does not anticipate making any loan guarantees in 2005.

Table 7–5. SUMMARY OF FEDERAL DIRECT LOANS AND LOAN GUARANTEES

(In billions of dollars)

	Actual								Estimate	
	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Direct Loans:										
Obligations	23.4	33.6	28.8	38.4	37.1	39.1	43.7	45.4	46.4	44.5
Disbursements	23.6	32.2	28.7	37.7	35.5	37.1	39.6	39.7	39.0	41.5
New subsidy budget authority [2]	*	*	–0.8	1.6	–0.4	0.3	*	0.7	0.5	0.2
Reestimated subsidy budget authority [1]	....	....	7.3	1.0	–4.4	–1.8	0.5	2.9	2.3	....
Total subsidy budget authority [3]	1.8	2.4	6.5	2.6	–4.8	–1.5	0.5	3.5	2.8	0.2
Loan Guarantees:										
Commitments	175.4	172.3	218.4	252.4	192.6	256.4	303.7	345.9	338.4	349.5
Lender disbursements	143.9	144.7	199.5	224.7	180.8	212.9	271.4	331.3	318.1	333.5
New subsidy budget authority [2]	*	*	3.3	*	3.6	2.3	2.9	3.8	3.6	4.7
Reestimated subsidy budget authority [1]	....	....	–0.7	4.3	0.3	–7.1	–2.4	–3.5	1.5	....
Total subsidy budget authority	4.0	3.6	2.6	4.3	3.9	–4.8	0.5	0.3	5.0	4.7

* Less than $50 million.

[1] Includes interest on reestimate.

[2] Prior to 1998 new and reestimated subsidy budget authority were not reported separately.

[3] GNMA secondary guarantees of loans that are guaranteed by FHA, VA and RHS are excluded from the totals to avoid double-counting.

Table 7–6. DIRECT LOAN WRITE-OFFS AND GUARANTEED LOAN TERMINATIONS FOR DEFAULTS

Agency and Program	In millions of dollars			As a percentage of outstanding loans [1]		
	2003 actual	2004 estimate	2005 estimate	2003 actual	2004 estimate	2005 estimate
DIRECT LOAN WRITEOFFS						
Agriculture:						
Agricultural credit insurance fund	158	151	140	1.95	1.99	1.98
Farm storage facility loans program	1	1	....	0.54	0.44	
Rural community advancement program	5	....	....	0.07	....	....
Rural electrification and telecommunications loans	....	109	98	....	0.34	0.29
Rural telephone bank	....	....	3	....	....	0.44
Rural development insurance fund	1	1	1	0.03	0.04	0.04
Rural housing insurance fund	153	142	135	0.57	0.54	0.53
Rural development loan fund	1	1	1	0.25	0.24	0.23
P.L.480	34	....	....	0.32	....	....
Debt reduction (P.L.480)	....	29	37	....	6.44	6.85
Commerce:						
Economic development revolving fund	1	1	1	3.84	4.54	5.55
Education:						
Student financial assistance	3	4	4	0.92	1.24	1.26
Housing and Urban Development:						
Revolving fund (liquidating programs)	1	1	1	8.33	16.66	25.00
Guarantees of mortgage-backed securities	3	4	21	2.91	3.47	16.53
Interior:						
Indian direct loan	2	2	2	3.92	4.44	5.12
Labor:						
Pension Benefit Guaranty Corporation	5	11	39	....	....	....
State:						
Repatriation loans	....	1	....	....	33.33	....
Transportation:						
Railroad rehabilitation and improvement	....	2	4	....	0.85	0.98
Treasury:						
Community development financial institutions fund	....	....	1	....	....	1.58
Veterans Affairs:						
Veterans housing benefit program	15	13	11	0.87	0.75	0.59
International Assistance Programs:						
Military debt reduction	....	....	14	....	....	5.83
Debt reduction (AID)	....	19	13	....	10.61	7.64
Overseas Private Investment Corporation	....	1	1	....	0.47	0.38
Small Business Administration:						
Disaster loans	47	43	43	1.39	1.35	1.18
Business loans	11	10	9	3.23	3.54	4.05
Other Independent Agencies:						
Export-Import Bank	570	48	45	5.17	0.47	0.48
Debt reduction (ExIm Bank)	13	17	41	4.65	3.61	8.24
Spectrum auction program	95	....	....	1.82	....	....
Tennessee Valley Authority	1	1	1	2.08	1.81	1.63
Total, direct loan writeoffs	**1,119**	**612**	**667**	**0.50**	**0.27**	**0.28**
GUARANTEED LOAN TERMINATIONS FOR DEFAULT						
Agriculture:						
Agricultural credit insurance fund	92	77	80	0.92	0.73	0.72
Commodity Credit Corporation export loans	102	172	184	2.38	3.81	3.27
Rural community advancement program	72	60	55	1.66	1.36	1.27
Rural electrification and telecommunications loans	....	6	6	....	0.57	0.37
Rural development insurance fund	27	....	....	41.53	....	....
Rural housing insurance fund	170	117	121	1.25	0.85	0.87
Commerce:						
Emergency oil and gas guaranteed loan program	....	1	....	....	100.00	....
Emergency steel guaranteed loan program	....	32	12	....	15.53	5.74
Defense—Military:						
Family housing improvement fund	....	3	4	....	0.78	1.06

Table 7–6. DIRECT LOAN WRITE-OFFS AND GUARANTEED LOAN TERMINATIONS FOR DEFAULTS—Continued

Agency and Program	In millions of dollars			As a percentage of outstanding loans [1]		
	2003 actual	2004 estimate	2005 estimate	2003 actual	2004 estimate	2005 estimate
Education:						
Federal family education loan	3,509	4,708	5,334	1.77	2.08	2.12
Health and Human Services:						
Health education assistance loans	56	58	58	2.42	2.43	2.44
Housing and Urban Development:						
Indian housing loan guarantee	....	1	1	....	1.56	1.38
Title VI Indian Federal guarantees program	....	1	1	....	1.36	1.25
FHA—Mutual mortgage insurance	7,410	4,681	4,533	1.69	1.08	0.90
FHA—General and special risk	1,740	1,903	1,773	1.87	2.13	1.90
Interior:						
Indian guaranteed loan	1	1	1	0.38	0.32	0.28
Transportation:						
Maritime guaranteed loan (Title XI)	....	30	35	....	0.81	0.87
Treasury:						
Air transportation stabilization	....	448	60	....	29.35	5.18
Veterans Affairs:						
Veterans housing benefit program	1,345	2,917	3,016	0.45	0.85	0.79
International Assistance Programs:						
Foreign military financing	....	3	11	....	0.09	0.37
Micro and small enterprise development	3	1	1	7.69	1.81	1.33
Urban and environmental credit program	54	41	42	2.71	2.23	2.49
Development credit authority	....	1	1	....	1.11	0.56
Overseas Private Investment Corporation	33	45	45	0.99	1.37	1.27
Small Business Administration:						
Business loans	1,255	2,325	1,272	2.65	4.19	2.03
Pollution control equipment	....	1	1	....	16.66	33.33
Other Independent Agencies:						
Export-Import Bank	215	368	391	0.66	1.07	1.11
Total, guaranteed loan terminations for default	**16,084**	**18,001**	**17,038**	**0.95**	**1.02**	**0.87**
Total, direct loan writeoffs and guaranteed loan terminations	**17,203**	**18,613**	**17,705**	**0.90**	**0.94**	**0.81**
ADDENDUM: WRITEOFFS OF DEFAULTED GUARANTEED LOANS THAT RESULT IN LOANS RECEIVABLE						
Agriculture:						
Agricultural credit insurance fund	1	1	1	11.11	11.11	11.11
Commerce:						
Fisheries finance	13	....	....	28.26	....	....
Education:						
Federal family education loan	213	196	198	1.16	1.08	1.05
Health and Human Services:						
Health education assistance loans	26	24	24	2.93	2.68	2.65
Housing and Urban Development:						
FHA—Mutual mortgage insurance	2	....	....	1.63	....	....
FHA—General and special risk	309	362	354	10.61	11.06	9.43
Interior:						
Indian guaranteed loan	18	3	....	51.42	13.63	....
Treasury:						
Air transportation stabilization	....	....	383	....	....	150.78
Veterans Affairs:						
Veterans housing benefit program	87	83	95	7.63	6.87	6.97
International Assistance Programs:						
Urban and environmental credit program	40	....	....	8.43	....	....
Small Business Administration:						
Business loans	543	302	574	28.10	9.98	14.33
Total, writeoffs of loans receivable	**1,252**	**971**	**1,629**	**3.93**	**2.83**	**4.46**

[1] Average of loans outstanding for the year.

Table 7–7. APPROPRIATIONS ACTS LIMITATIONS ON CREDIT LOAN LEVELS[1]

(In millions of dollars)

Agency and Program	2003 Actual	Estimate	
		2004	2005
DIRECT LOAN OBLIGATIONS			
Agriculture:			
Agricultural credit insurance fund	1,006	844	937
Distance learning, telemedicine, and broadband	300	898	291
Rural electrification and telecommunications	4,454	4,404	3,035
Rural telephone bank	172	174	....
Rural water and waste disposal direct loans	789	1,032	1,000
Rural housing insurance fund	1,260	1,563	1,259
Rural community facility direct loans	255	500	300
Rural economic development	15	15	25
Rural development loan fund	40	40	34
P.L. 480 direct credit	44	38	30
Commerce:			
Fisheries finance	24	24	30
Education:			
Historically black college and university capital financing	269	269	170
Homeland Security:			
Disaster Assistance Direct Loan Financing Account	25	25	25
Housing and Urban Development:			
FHA-general and special risk	50	50	50
FHA-mutual mortgage insurance	50	50	50
Interior:			
Assistance to American Samoa	1	1	1
State:			
Repatriation loans	1	1	1
Transportation:			
Transportation infrastructure finance and innovation program	2,200	2,200	2,200
Transportation infrastructure finance and innovation program line of credit	200	200	200
Treasury:			
Community development financial institutions fund	11	11	11
Veterans Affairs:			
Native American and transitional housing	....	50	30
Vocational rehabilitation and education	3	4	4
International Assistance Programs:			
Foreign military financing	3,800	550	....
Military debt reduction	....	32	....
Small Business Administration:			
Business loans	25	20	....
Total, limitations on direct loan obligations	**14,994**	**12,995**	**9,683**
LOAN GUARANTEE COMMITMENTS			
Agriculture:			
Agricultural credit insurance fund	2,766	2,401	2,866
Rural electrification and telecommunications guaranteed loans	....	100	100
Rural water and waste water disposal guaranteed loans	75	75	75
Distance learning and telemedicine	....	....	40
Rural housing insurance fund	3,186	2,809	2,825
Rural community facility guaranteed loans	210	210	210
Rural business and industry guaranteed loans	845	552	600
Defense—Military:			
Arms initiative	17	16	....
Health and Human Services:			
Health education assistance loans	160	150	....
Housing and Urban Development:			
Indian housing loan guarantee fund	197	197	29
Title VI Indian Federal guarantees	17	18	18
Native Hawaiian housing loan guarantee fund	40	40	37
Community development loan guarantees	273	273	....

Table 7–7. APPROPRIATIONS ACTS LIMITATIONS ON CREDIT LOAN LEVELS[1]—Continued

(In millions of dollars)

Agency and Program	2003 Actual	Estimate	
		2004	2005
FHA-general and special risk	25,000	25,000	35,000
FHA-mutual mortgage insurance	165,000	185,000	185,000
Interior:			
Indian loan guarantee	72	84	86
Transportation:			
Minority business resource center	18	18	18
Transportation infrastructure finance and innovation program loan guarantee	200	200	200
International Assistance Programs:			
Loan guarantees to Israel	3,000	3,000	3,000
Development credit authority	....	700	700
Small Business Administration:			
Business guarantee	15,318	20,986	29,000
Total, limitations on loan guarantee commitments	**216,394**	**241,829**	**259,804**
ADDENDUM: SECONDARY GUARANTEED LOAN COMMITMENT LIMITATIONS			
Housing and Urban Development:			
Guarantees of mortgage-backed securities	200,000	200,000	200,000
Total, limitations on secondary guaranteed loan commitments	**200,000**	**200,000**	**200,000**

[1] Data represents loan level limitations enacted or proposed to be enacted in appropriation acts. For information on actual and estimated loan levels supportable by new subsidy budget authority requested, see Tables 7–3 and 7–4.

Table 7–8. FACE VALUE OF GOVERNMENT-SPONSORED ENTERPRISE LENDING [2]

(In billions of dollars)

	Outstanding	
	2002	2003
Government Sponsored Enterprises: [1]		
Fannie Mae[1]	1,689	2,086
Freddie Mac [2]	1,255	N/A
Federal Home Loan Banks [3]	524	758
Sallie Mae [4]	....	....
Farm Credit System	83	86
Total [2]	**3,551**	**N/A**

N/A = Not applicable.

[1] Net of purchases of federally guaranteed loans.

[2] 2003 financial data for Freddie Mac is not presented here because the company has not yet reported financial results for 2003. In addition, on November 21, 2003, Freddie Mac announced the results of its restatement of previously issued consolidated financial statements for the years 2000 and 2001 and the first three quarters of 2002 and the revision of fourth quarter and full-year consolidated financial statements for 2002 (collectively referred to as the ''restatement''). This restatement has changed the data provided last year in the 2004 Budget. Restated data for 2002 has not yet been audited.

[3] The lending by the Federal Home Loan Banks measures their advances to member thrift and other financial institutions. In addition, their investment in private financial instruments at the end of 2003 was $186 billion, including federally guaranteed securities, GSE securities, and money market instruments. The change between 2002 and 2003 is not comparable because of discontinuity in the data series.

[4] The face value and Federal costs of Federal Family Education Loans in the Student Loan Marketing Association's portfolio are included in the totals for that program under guaranteed loans in table 7–1.

Table 7–9 LENDING AND BORROWING BY GOVERNMENT-SPONSORED ENTERPRISES (GSEs)[1,2]

(In millions of dollars)

Enterprise	2003
Student Loan Marketing Association:	
Net change	–14,009
Outstandings	27,923
Federal National Mortgage Association:	
Portfolio programs:	
Net change	162,939
Outstandings	922,672
Mortgage-backed securities:	
Net change	220,989
Outstandings	1,210,263
Federal Home Loan Mortgage Corporation:[1]	
Portfolio programs:	
Net change	N/A
Outstandings	N/A
Mortgage-backed securities:	
Net change	N/A
Outstandings	N/A
Farm Credit System:	
Agricultural credit bank:	
Net change	2,997
Outstandings	23,463
Farm credit banks:	
Net change	188
Outstandings	58,353
Federal Agricultural Mortgage Corporation:	
Net change	....
Outstandings	6,000
Federal Home Loan Banks:	
Net change	232,687
Outstandings	770,499
Less guaranteed loans purchased by:	
Student Loan Marketing Association:	
Net change	–14,009
Outstandings	27,923
Federal National Mortgage Association:	
Net change	–12,843
Outstandings	47,300
Other:	
Net change[3]	N/A
Outstandings[1]	13,897
BORROWING	
Student Loan Marketing Association:	
Net change	–18,899
Outstandings	26,821
Federal National Mortgage Association:	
Portfolio programs:	
Net change	175,479
Outstandings	975,734
Mortgage-backed securities:	
Net change	220,989
Outstandings	1,210,263
Federal Home Loan Mortgage Corporation:[1]	
Portfolio programs:	
Net change	N/A
Outstandings	N/A
Mortgage-backed securities:	
Net change	N/A
Outstandings	N/A
Farm Credit System:	
Agricultural credit bank:	
Net change	3,938
Outstandings	26,451

Table 7–9 LENDING AND BORROWING BY GOVERNMENT-SPONSORED ENTERPRISES (GSEs) [1,2]—Continued

(In millions of dollars)

Enterprise	2003
Farm credit banks:	
Net change	4,255
Outstandings	68,049
Federal Agricultural Mortgage Corporation:	
Net change	764
Outstandings	3,838
Federal Home Loan Banks:	
Net change	49,325
Outstandings	716,886
DEDUCTIONS	
Less borrowing from other GSEs:	
Net change [3]	N/A
Outstandings [1]	78,370
Less purchase of Federal debt securities:	
Net change [3]	N/A
Outstandings [1]	3,094
Less borrowing to purchase loans guaranteed by:	
Student Loan Marketing Association:	
Net change	–14,009
Outstandings	27,923
Federal National Mortgage Association:	
Net change	–12,843
Outstandings	47,300
Other:	
Net change [3]	N/A
Outstandings [1]	13,897

N/A = Not applicable.

The estimates of borrowing and lending were developed by the GSEs based on certain assumptions that are subject to periodic review and revision and do not represent official GSE forecasts of future activity, nor are they reviewed by the President. The data for all years include programs of mortgage-backed securities. In cases where a GSE owns securities issued by the same GSE, including mortgage-backed securities, the borrowing and lending data for that GSE are adjusted to remove double-counting.

[1] Financial data for Freddie Mac is not presented here because the company has not yet reported financial results for 2003. In addition, on November 21, 2003, Freddie Mac announced the results of its restatement of previously issued consolidated financial statements for the years 2000 and 2001 and the first three quarters of 2002 and the revision of fourth quarter and full-year consolidated financial statements for 2002 (collectively referred to as the ‘‘restatement’’). This restatement has changed the data provided last year in the 2004 Budget. Restated data for 2002 has not yet been audited.

[2] Totals and subtotals have not been calculated because a substantial portion of the total, Freddie Mac, is subject to the above-described restatement.

[3] Not calculated due to discontinuity in the data series.

8. AID TO STATE AND LOCAL GOVERNMENTS[1]

State and local governments have a vital constitutional responsibility to provide government services. They have the major role in providing domestic public services, such as public education, law enforcement, roads, water supply, and sewage treatment. The Federal Government contributes to that role by promoting a healthy economy. It also provides grants, loans, and tax subsidies to State and local governments.

Federal grants help State and local governments finance programs covering most areas of domestic public spending, including income support, infrastructure, education, and social services. Federal grant outlays were $387.3 billion in 2003 and are estimated to be $418.1 billion in 2004 and $416.5 billion in 2005. The reduction from 2004 to 2005 is due primarily to temporary grant increases in 2003 and 2004 for Medicaid and fiscal assistance that were enacted as part of the economic recovery proposals.

Grant outlays to State and local governments for individuals, such as Medicaid payments, are estimated to be 65 percent of total grants in 2005; grant outlays for physical capital investment, 15 percent; and grant outlays for all other purposes, largely education, training, and social services, 20 percent.

Some tax expenditures also constitute Federal aid to State and local governments. Tax expenditures stem from special exclusions, exemptions, deductions, credits, deferrals, or tax rates in the Federal tax laws.

The deductibility of State and local personal income and property taxes from gross income for Federal income tax purposes and the exclusion of interest on State and local public purpose bonds from Federal taxation comprise the two largest tax expenditures benefiting State and local governments. These provisions, on an outlay equivalent basis, are estimated to be $103 billion in 2005. Chapter 18, “Tax Expenditures,” of this volume provides a detailed discussion of the measurement and definition of tax expenditures and a complete list of the estimated costs of specific tax expenditures. As discussed in that chapter, there are generally interactions among tax expenditure provisions, so that the total cost estimates only approximate the aggregate effect of these provisions. Tax expenditures that especially aid State and local governments are displayed separately at the end of Table 18–5 in that chapter, and also at the ends of Tables 18–1 and 18–2.

For the first time, this chapter includes information on the performance of selected grant programs based on the Program Assessment Rating Tool. An Appendix to this chapter includes State-by-State estimates of major grant programs.

Table 8–1. FEDERAL GRANT OUTLAYS BY AGENCY

(In billions of dollars)

	2003 Actual	Estimate	
		2003	2004
Department of Agriculture	23.2	23.9	24.0
Department of Commerce	0.6	0.9	0.6
Department of Education	32.5	38.6	39.1
Department of Energy	0.3	0.3	0.3
Department of Health and Human Services	222.0	240.3	245.6
Department of Homeland Security	8.0	7.2	7.0
Department of Housing and Urban Development	31.8	34.1	34.1
Department of the Interior	3.0	3.2	3.5
Department of Justice	4.1	3.8	3.6
Department of Labor	8.9	7.8	6.8
Department of Transportation	41.0	43.5	44.9
Department of the Treasury	5.4	5.5	0.4
Department of Veterans Affairs	0.4	0.4	0.5
Environmental Protection Agency	3.9	4.3	3.8
Other agencies	2.0	4.4	2.5
Total	387.3	418.1	416.5

Table 8–1 shows the distribution of grants by agency. Grant outlays by the Department of Health and Human Services are estimated to be $245.6 billion in 2005, almost 60 percent of total grant outlays. Grant outlays for the Department of the Treasury decline in 2005 due to temporary fiscal assistance grants enacted for 2003 and 2004 as part of the economic recovery proposals.

HIGHLIGHTS OF THE FEDERAL AID PROGRAM

Several proposals in this budget affect Federal aid to State and local governments and the important relationships between the levels of government. Through the use of grants, the Federal Government shares with State and local governments the cost and, ultimately, the benefits of a better educated, healthier, and safer citizenry. The Administration intends to work with State and local governments to make the Federal system more efficient and effective and to improve the design, administration, and financial management of Federal grant programs. The Administration will achieve these goals through various efforts.

In programs where the Federal Government and State and local governments partner in the provision of services, State and local government involvement is critical to improving the performance of Federal pro-

[1] Federal aid to State and local governments is defined as the provision of resources by the Federal Government to support a State or local program of governmental service to the public. The three primary forms of aid are grants, loan subsidies, and tax expenditures.

grams. To date, the Administration has rated the effectiveness of about two fifths of all Federal programs using the Program Assessment Rating Tool (PART). On average, grant programs received lower ratings than other types of programs, which suggests the need for strengthening partnerships and accountability for achieving program outcomes.

In support of the Administration's initiative to identify and eliminate erroneous payments, managers of several programs jointly administered by the Federal Government and the States, including Medicaid and the School Lunch program, are developing methodologies to estimate improper payment rates, identify the causes and remedy them. The passage of the Improper Payments Information Act of 2002 codified the requirement of the President's initiative to estimate the extent of erroneous payments for all Federal programs and activities. Following the passage of the Act, OMB issued guidance to agencies to assist with the expanded reporting requirements in the statute. Now, all major agencies are beginning to develop and implement plans to identify and eliminate erroneous payments within all programs and activities.

In addition, under the auspices of the Federal Financial Assistance Management Improvement Act of 1999 (PL 106–107) and the Administration's Grant.Gov initiative, the Federal grant making agencies have worked individually and collectively to improve and streamline the efficiency of grant programs. Particularly, in 2003, the Federal Government has realized its objectives to:

- establish a single website to house synopses of Federal grant funding opportunities;
- develop and implement a standard format for communicating the details of those funding opportunities; and
- enable electronic receipt of applications.

Highlights of grants to State and local governments are presented below. For additional information on grants, see Table 8–4 in this Chapter, and discussions in the main budget volume.

Homeland Security

Because homeland security is a national challenge, not just a Federal challenge, State, local, regional, and tribal governments are vital to fighting terrorism and safeguarding our homeland. From 2001 through 2004, the Department of Homeland Security (DHS) and its predecessor agencies provided over $11 billion for terrorism and other emergency preparedness needs of State and local responders. When combined with funds in the Departments of Health and Human Services (HHS) and Justice (DOJ), State and local assistance has totaled $15.8 billion.

This funding has allowed unprecedented investments in critical equipment, hundreds of coordinated exercises, training for over 500,000 first responders, and development of a homeland security strategy for every State and most major cities. These funds have also enabled a dramatic expansion of Citizen Corps initiatives, enabling community-based volunteers to support front-line responders. A major challenge for the Department is to ensure that such grant funds are used effectively. The Federal Government has provided an enormous investment in these programs and these funds must be targeted to leverage State and local resources to meet terrorist threats, and not simply supplant State and local public safety funding. To that end, DHS is developing national domestic preparedness goals that will establish measurable targets that encompass readiness for various hazards, including terrorist attacks, major disasters, and other emergencies.

The *2005 Budget* request provides funding of $3.6 billion in the Office for Domestic Preparedness to continue these enhancements and achieve national preparedness goals—including a doubling of the Urban Area Security Initiative (UASI), which has provided more than $1.5 billion over the last two years for "high-threat" urban areas. This shifting away from arbitrary formulas to "high-threat" allocations will enable the Department to reinvigorate its commitment to providing homeland security funds based on terrorism risks, threats, and vulnerabilities. DHS will also continue grants for law enforcement terrorism prevention efforts, and direct grants to improve the response of fire departments to terrorism and other major incidents.

Education

Leaving no child behind. When President Bush entered office, two-thirds of all low-income fourth graders could not read on grade level, and the achievement gap between rich and poor was growing. On January 8, 2002, President Bush signed into law the No Child Left Behind Act and forever changed public education in America. Local schools are now held accountable for rigorous achievement goals for all students, parents are provided with detailed information on school performance, and students in under-performing schools have the option to attend a school that demonstrates results. The *2005 Budget* continues the President's unprecedented commitment to K-12 education and to helping schools meet the new challenges of No Child Left Behind, providing $13.3 billion for Title I grants, a $1.0 billion increase from last year, and a $4.6 billion, or 52 percent, increase since the President took office. With the *2005 Budget*, funding for reading programs will have increased more than four-fold since 2001—for a total of $1.3 billion—with a goal that every child be able to read at grade level or above by the end of third grade.

Renewing America's commitment to students with special needs. America's schools need better tools to improve services for students with disabilities—11 percent of all students. The President is committed to reforms for Federal special education programs that increase accountability for results, reduce administrative burdens on States and schools, enhance the role of parents, and ensure that research-based practices are widely used. The *2005 Budget* demonstrates the President's commitment to serving students with disabilities by providing $11.1 billion for Special Education Grants to States, a $1.0 billion increase from last year, and a $4.7 billion (or 75 percent) increase since the President took office.

Training and Employment

The Administration will continue pressing in 2005 for significant improvements in existing Federal employment and training programs. The Administration is requesting $4.3 billion in budget authority for 2005 for grants in the training and employment services programs in the Department of Labor (DOL) to support these activities.

The Workforce Investment Act's (WIA) expiration presents an opportunity to improve Federal employment and training programs by eliminating redundancies, strengthening resource allocation, improving accountability, enhancing the role of employers in the national workforce system, and increasing State flexibility. The Administration proposes to:

- ***Clarify roles and eliminate overlap.*** The Administration proposes to target resources more effectively by increasing State flexibility.
- ***Combine three programs into a single adult training grant.*** The new grant proposes to consolidate the WIA adult and dislocated worker programs and Employment Service State grants into a single funding stream. This reform will give States and DOL greater ability to target resources where needed, promote coordination, and eliminate duplication among current services for adults.
- ***Tap unused resources to target areas of need.*** For the past few years, large amounts of WIA State formula grants funding have remained unspent in the Federal Treasury at the end of the year. In 2004, these balances will exceed $1.4 billion. While total unexpended balances remain high, some States and localities have exhausted the resources available to them. The *2005 Budget* uses unspent formula grant balances to maintain or increase service levels and provide more flexibility to DOL and States to reallocate and target funding where it is most needed.
- ***Focus the Department of Labor's role in serving youth.*** The reformed program will minimize overlap identified in the Program Assessment Rating Tool (PART) between DOL and the Department of Education. Through targeted formula grants and competitive grants, the reformed program will focus DOL's resources on out-of-school youth programs and non-school programs that support academic achievement. The competitive grants will support programs designed to help youth acquire the skills, credentials, and experience they need to succeed in the labor market.
- ***Continue program eliminations proposed in the 2004 Budget.*** This budget continues to recommend serving all workers through the core WIA system and ending narrow-purpose programs identified as ineffective or duplicative. The budget proposes the elimination of the Migrant and Seasonal Farmworkers program deemed "ineffective" by the PART and the H-1B Training Grants, which have not been proven successful in raising the skills of U.S. workers in specialty occupations.

Social Services

In April 2002, building on his Administration's emphasis on preschool programs, President Bush announced the Good Start, Grow Smart preschool education initiative with three goals:

- Strengthening Head Start;
- Partnering with States to improve early childhood education; and
- Providing information on child development and early learning to teachers, caregivers, parents, and grandparents and closing the gap between research and practice in early childhood education.

The initiative recognizes that for Head Start, achieving program goals means not only improving children's health and nutrition, but preparing them to succeed in kindergarten and beyond. Research shows that Head Start can achieve better school-readiness for its children by specifying particular skills and abilities to be taught in pre-reading, language, mathematics, cognitive skills and social/emotional competencies. To support this goal, the Administration has proposed a new demonstration authority permitting States to assume financial and operational control of Head Start. The budget increases Head Start by $169 million, including $45 million in additional Head Start funding in 2005 to support State implementation of the demonstration authority to promote better coordination of existing programs, to improve services for families and children, and to achieve better results with the resources already being used. This budget requests $6.9 billion in budget authority for Head Start for 2005.

Income Support

Food and nutrition assistance. The Administration strongly supports child nutrition programs and seeks to ensure that all eligible children are served. The Administration wants to work with the Congress to make improvements in program integrity and well targeted investments to improve the nutritional quality of meals. The budget fully funds child nutrition and provides for the extension of a number of expiring provisions to ensure that all aspects of the program continue to operate without interruption.

The Special Supplemental Nutrition Program for Women, Infants and Children, more commonly known as the WIC Program, serves the nutritional needs of low-income pregnant and post-partum women, infants, and children up to their fifth birthday. The President's Budget reproposes a WIC reauthorization plan to provide $4.7 billion for WIC services, full funding for all those estimated to be eligible and seeking services. If these funds are insufficient, the Administration will work with the Congress to ensure eligible individuals seeking services can access this important program. In addition, the funds will support: a breastfeeding peer counselor program to target nutrition education and information to increase breastfeeding initiation and duration; test programs to see if WIC can help prevent childhood obesity; an independent, comprehensive evaluation of the effectiveness of the WIC program; and efforts to improve State WIC agencies' management information systems.

In 2003, Congress enacted the Administration-proposed contingency fund, which remains available, to ensure that the WIC program can expand to serve an increasing number of eligible persons should that be necessary.

Housing assistance. The Administration is requesting $24.2 billion in budget authority for housing assistance to State and local governments for 2005. Major housing initiatives for this budget include homeless assistance and housing vouchers.

Homeless assistance. The Administration continues the commitment made in 2002 to end chronic homelessness within a decade. Innovative local strategies are being funded through a variety of interagency initiatives to move chronically homeless individuals from the street to permanent supportive housing and to prevent such people from falling into homelessness in the first place.

The chronically homeless are a sub-population of perhaps 150,000 individuals who often have an addiction or suffer from a disabling physical or mental condition. They are homeless for extended periods of time or experience multiple episodes of homelessness. Research indicates that although these individuals may comprise less than 10 percent of the homeless population, they consume a disproportionately large amount of emergency homeless services because their needs are not comprehensively addressed. Thus, they remain in the homeless system or on the street.

To help realize the Administration's goal, the U.S. Interagency Council on Homelessness has been working closely with communities across the country to create local plans. Already, 41 States have created State interagency councils to combat homelessness, and 80 cities and counties have agreed to develop 10-year plans.

This budget requests $1.3 billion in budget authority for Department of Housing and Urban Development (HUD) homeless assistance grants for 2005.

Housing vouchers. The Housing Choice Voucher program provides two million low-income families with subsidies to help them afford a decent place to live. They pay 30 percent of their income; the Government pays the rest. In the past, funds have been appropriated for a specific number of units each year. These funds were then given to public housing agencies (PHAs) based on the number of vouchers they were awarded. HUD and the Congress are concerned that voucher costs have increased at a rate of more than double the average increase in the private rental market for the past two years. This rate of increase, combined with an extremely complex set of laws and rules that govern the program has limited the effectiveness of the program.

The Administration proposes to simplify the program and give more flexibility to PHAs to administer the program to better address local needs. Building on changes in the 2004 Consolidated Appropriations bill, the Administration proposes switching from a "unit-based" approach to a "dollar-based" approach. PHAs would receive a fixed dollar amount but would have the freedom to adjust the program to the unique and changing needs of their community, including the ability to set their own rents based on local market conditions rather than having HUD predict and set rents for every market in the nation. These changes would provide a more efficient and effective program by eliminating large balances of unused resources (a concern noted in the 2004 PART review) and helping low-income families more easily obtain decent, safe, affordable housing.

This budget requests $12.6 billion in budget authority for grants for housing vouchers for 2005.

Other income security. In 1996, the Congress passed legislation to create the Temporary Assistance for Needy Families (TANF) program, replacing Aid to Families with Dependent Children and related welfare programs. TANF is a block grant with bonuses for performance, with estimated grant outlays of $18.4 billion in 2005. States have significant flexibility in designing the eligibility criteria and benefit rules for their TANF programs, which require and reward work in exchange for time-limited benefits. TANF is considered one of the most successful federally-funded domestic programs in decades. Nationally, the TANF caseload (number of cash recipients) has declined 60 percent since the program's inception, while average monthly earnings of those employed increased by 49 percent from 1996 to 2001. As a result, States are using an increasing portion of welfare dollars on services to help individuals retain and advance in their jobs. Building on these successes, the Administration continues to pursue its plan to extend the TANF program. The Administration's plan maintains funding, strengthens work participation requirements, supports healthy marriages and family formation, and provides a more accessible contingency fund.

Health

Medicaid and State Children's Health Insurance Program (SCHIP). Close to 42 million individuals were enrolled in Medicaid in 2003. Medicaid covers approximately one-fourth of the Nation's children and is the largest single purchaser of maternity care and nursing home/long-term care services in the United States. In 2003, the elderly and those with disabilities represented approximately 30 percent of Medicaid beneficiaries but account for two-thirds of its spending. Total Medicaid spending will be an estimated $322 billion ($182 billion Federal share) in 2005.

SCHIP was established in 1997 to make available approximately $40 billion over ten years for States to provide health care coverage to low-income, uninsured children. SCHIP gives States broad flexibility in program design while protecting beneficiaries through Federal standards. Since the beginning of the Administration, enrollment in SCHIP has grown by over 1 million children, to approximately 5.3 million in 2002.

Over the past year, the Administration has held productive discussions with stakeholders on ways to modernize the Medicaid and SCHIP programs based on an Administration proposal included in the *2004 Budget*. A common complaint among States is that the complex array of Medicaid laws, regulations, and administrative guidance is confusing, overly burdensome, and serves to stifle State innovation and flexibility. The creation of the SCHIP program created new opportunities for States, but because rules governing Medicaid and SCHIP differ in significant respects, coordination of the two programs has proven difficult. As a result, States frequently request waivers to tailor their Medicaid and SCHIP programs to their specific insurance markets or to expand eligibility to the uninsured beyond mandatory groups.

Years of States' experience with implementing home and community based waiver programs, waiver programs to extend Medicaid coverage to higher income and non-traditional populations, and implementation of the SCHIP program provide States with a wealth of knowledge and a multitude of strategies to design more efficient and effective programs. Further, in August 2001, the Administration introduced the Health Insurance Flexibility and Accountability (HIFA) demonstration initiative. These experiences give States knowledge of the flexibility they need to design tailored, innovative approaches to increase access to health insurance coverage for the uninsured. The Administration remains committed to enacting legislation that will reform Medicaid and SCHIP to give States as much flexibility as possible with predictable financing.

Health Centers. The Administration is requesting $1.8 billion for 2005 for grants to locally managed health centers. These centers deliver high-quality, affordable health care to over 13 million patients at 3,600 sites across the United States. These centers serve individuals that live in underserved and rural areas and their clients include low income individuals, migrant farm workers, homeless individuals, school children, individuals in need of drug and alcohol treatment, and HIV/AIDS infected individuals. In many areas, Health Centers are the only primary care facilities readily available.

The President's Health Centers Initiative is creating 1,200 new and expanded health center sites to serve an additional 6.1 million people by 2006. The budget would help more than 1.6 million additional low-income individuals receive health care in 2005 through 332 new and expanded sites in rural areas and underserved urban neighborhoods.

Natural Resources and Environment

This budget continues the President's commitment to the Clean Water and Drinking Water State Revolving Funds (SRFs). SRFs provide States and communities with a long-term source of funding for water infrastructure to protect public health and the environment. Since the Clean Water SRF's inception in 1988, EPA has provided nearly $20 billion of Federal investment, with over $5 billion provided since 2001. These funds have allowed States to make available over $47 billion in loans to municipalities. These loans have helped finance over 14,000 wastewater projects, such as treatment plant and sewer construction. This budget requests $850 million in budget authority for 2005 for the Clean Water SRF, resulting in a long-term average revolving level of $3.4 billion.

The budget also fully supports the President's commitment to the Drinking Water SRF. With cumulative Federal capitalization totaling $5 billion, the Drinking Water SRF has made available $6.4 billion in loans and financed over 3,000 drinking water infrastructure improvement projects nationwide. The President also proposes to fund the Drinking Water SRF at $850 million in budget authority for 2005, resulting in a long-term average revolving level of $1.2 billion. In the coming year, EPA will improve both SRFs' ability to link their activities to environmental and public health outcomes, consistent with PART recommendations.

Administration of Justice

The Administration is requesting more than $2.7 billion in grant resources to assist State and local law enforcement, mostly comprised of grants administered by the Department of Justice ($2.2 billion). Within the Justice request:

- The Administration proposes consolidation of Byrne grants, Local Law Enforcement Block Grants, and COPS Hiring grants—which have multiple and overlapping purposes—into a simplified, flexible Justice Assistance Grant program, to be funded at more than $0.5 billion.
- The Office on Violence Against Women will administer almost $350 million in grants authorized under the Violence Against Women Act that help to counter domestic violence and its effects on women and families.
- The Office of Justice Programs will provide $142 million in grants for critical drug intervention strategies designed to steer drug offenders into specialized "Drug Courts" that can offer treatment alternatives, and to help offenders kick their habits-even while incarcerated-through the "Residential Substance Abuse Treatment" program.

Transportation

Grants support State and local programs for highways, mass transit, and airports. For grants to State and local governments for 2005, this budget includes:

- $33.6 billion in budgetary resources for Federal-aid highway programs to maintain and improve surface transportation infrastructure, along with improvements in the physical condition and safety of the facilities;
- $7.3 billion in budgetary resources to assist with mass transit projects, including $1.5 billion for

major capital transit projects ("New Starts") and $148 million to expand transportation options available to individuals with disabilities; and

- $3.5 billion in budgetary resources for airports. These funds will continue to support major capacity, safety, and noise mitigation projects that provide the greatest benefits to the national system, while targeting airports with significant needs.

Community and Regional Development

The Community Development Block Grant (CDBG) program provides annual grants totaling $4.3 billion each year to over 1,000 eligible cities, counties, and States to help develop viable urban communities in our Nation's distressed areas. The primary strength of the program is the flexibility each community has to spend funds on the areas of greatest local need such as housing, economic development, and public facilities. Alternatively, a weakness is that local governments often spread CDBG funds across many different areas, which reduces the ability to achieve the program's primary objective—revitalizing distressed neighborhoods.

This year, the Administration rated the CDBG program as needing improvement based on several areas of weakness:

- lack of clarity in the program's purpose and design;
- weak targeting of funds by the CDBG formula and by grantees to areas of greatest need;
- lack of transparent program and performance information; and
- lack of annual output and long-term outcome performance measures.

Many of these issues result from an ambiguous mission, loose targeting requirements, and local pressure to spread funds across many groups. To address this, the Administration wants to clarify that the purpose—and only meaningful measure of a successful local CDBG program—is a city's ability to transform distressed neighborhoods. The Administration plans to work with stakeholders to identify ways to increase local accountability, improve targeting of funds, and demonstrate results, including legislative reforms.

Other Functions

Discussions of these and other Federal aid programs can be found in the main budget volume and elsewhere. As noted earlier, a detailed listing of budget authority and outlays for all grants to State and local governments is in Table 8–4 in this chapter.

PERFORMANCE OF GRANTS TO STATE AND LOCAL GOVERNMENTS

The Administration is committed to measuring and improving the performance of Government programs. The Congress mandated in the Government Performance and Results Act of 1993 that performance plans be developed and that the agencies report annual progress against these plans.

In addition, this Administration began in the *2004 Budget* to assess every Federal program over a five year period in an assessment strategy known as the Program Assessment Rating Tool, or PART. With this budget, the second year of using the PART, the Administration has evaluated about two-fifths of the programs of the Federal Government.

The PART system assesses each program on four components (purpose, planning, management, and results/accountability) and gives a score for each of the components. The scores for each component are then weighted—results/accountability carries the greatest weight—and the program is given an overall score. A program is rated effective if it receives an overall score of 85 percent or more, moderately effective if the score is 70 to 85 percent, adequate if the score is 50 to 70 percent, and inadequate if the score is 49 percent or lower. The program is given a rating "Results Not Demonstrated" if the program does not have a good performance measure or does not have data for that measure. Chapter 2 of this volume discusses the PART in more detail.

As shown in Table 8–2, 100 of the programs that have been assessed are primarily grants to State and local governments. Of these 100, 46 programs, or 46 percent of all grant programs assessed, received a rating of "Results Not Demonstrated". This is higher than for all programs, in which 37 percent were given this rating. The higher percent of grants that have this rating might be explained in part because of the breadth of purpose of some grants, lack of agreement among grantees and Federal parties on the purpose and performance measure(s), and therefore lack of focused planning to achieve common goals.

Table 8–2 also shows that the average weighted score for the 100 grant programs that have been rated by PART was 53 percent, which is a rating of "adequate". These programs had total spending of $133.2 billion in 2003. Of these 100 programs:

- 46 were rated "results not demonstrated" ($43.2 billion);
- 2 were rated effective ($5.4 billion);
- 20 were rated moderately effective ($55.3 billion);
- 22 were rated adequate ($19.0 billion); and
- 10 were rated ineffective ($10.3 billion).

If the 46 programs rated "Results Not Demonstrated" are excluded, the average score for the remaining 54 programs was 62 percent, higher than the rating for all 100 grants but still a rating of "adequate".

Table 8–2. SUMMARY OF PART RATINGS AND SCORES FOR GRANTS TO STATE AND LOCAL GOVERNMENTS

Components	Average Scores	
	All grant programs	Programs excluding grants rated "results not demonstrated"
Purpose	80%	80%
Planning	60%	76%
Management	70%	76%
Results/Accountability	34%	46%
Weighted average [1]	53%	62%
Average rating	Adequate	Adequate
Rating [2]	Number of grants programs	2003 Program Level (in millions)
Results not demonstrated	46	43,187
Effective	2	5,350
Moderately effective	20	55,341
Adequate	22	19,045
Ineffective	10	10,275
Total number of grant programs rated	100	133,198

[1] Weighted as follows: Purpose (20%), Planning (10%), Management (20%), Results/Accountability (50%).

[2] The rating of effective indicates a score of 85 percent or more; moderately effective, 70–85 percent; adequate, 50–70 percent; and ineffective, 49 percent or less.

The ratings of the largest five of these 100 grant programs are summarized here. More complete summaries of these and other programs are in the enclosed *Analytical Perspectives* CD ROM.

- D*epartment of Transportation: Highway Infrastructure ($29.8 billion in 2003).* Rating: *Moderately Effective.* This program provides financial and technical assistance to States to construct and maintain a national system of roads and bridges. The assessment found that the program has been generally successful in improving highway safety and maintaining mobility, but that it should also take steps to improve oversight of State management of Federal highway dollars.
- *Department of Housing and Urban Development (HUD): Housing Vouchers ($12.5 billion in 2003).* Rating: *Moderately Effective.* This program provides assistance to extremely low-income households so they can afford to go out on their own and rent apartments in the private market. This program received a relatively high score in comparison with other HUD programs because it is a potentially cost-effective alternative to other forms of housing assistance. However, some of the Public Housing Authorities (PHAs) that administer the vouchers are poor managers. The Administration is proposing reforms to allow PHAs greater flexibility in the use of funds and to lessen administrative burdens.
- *Department of Education: IDEA Grants to States ($8.9 billion in 2003).* Rating: *Results Not Demonstrated.* The Individuals with Disabilities Education Act (IDEA) grants to States program provides funds for special education and related services to students aged 3–21 with disabilities. While IDEA funding grew from $5.0 billion in 2000 to $8.9 billion in 2003, there is no evidence that this funding has further improved educational outcomes for children with disabilities.
- *Department of Health and Human Services: Head Start ($6.7 billion in 2003).* Rating: *Results Not Demonstrated.* This program provides grants to local public, non-profit, and for-profit programs to help low-income children prepare for school and improve their overall development. The current program design is flawed because it does not hold individual grantees responsible for effectively preparing children for school.
- *Department of Agriculture: National School Lunch ($6.4 billion in 2003).* Rating: *Results Not Demonstrated.* This program provides funds to States for lunches served to children in schools. This program is generally well designed and has a clear purpose, however, a large proportion of children certified for free and reduced price meal benefits are from households with incomes above the program's eligibility thresholds. While the assessment was based largely on existing measures, these measures do not adequately demonstrate results.

HISTORICAL PERSPECTIVES

In recent decades, Federal aid to State and local governments has become a major factor in the financing of certain government functions. The rudiments of the present system date back to the Civil War. The Morrill Act, passed in 1862, established the land grant colleges and instituted certain federally-required standards for States that received the grants, as is characteristic of the present grant programs. Federal aid was later initiated for agriculture, highways, vocational education and rehabilitation, forestry, and public health. In the depression years, Federal aid was extended to meet income security and other social welfare needs. However, Federal grants did not become a significant factor in Federal Government expenditures until after World War II.

Table 8–3 displays trends in Federal grants to State and local governments since 1960. Section A shows Federal grants by function. Functions with a substantial amount of grants are shown separately. Grants for the national defense, energy, social security, and the veterans benefits and services functions are combined in the "other functions" line in the table.

Table 8–3. TRENDS IN FEDERAL GRANTS TO STATE AND LOCAL GOVERNMENTS

(Outlays; in billions of dollars)

	Actual										Estimate	
	1960	1965	1970	1975	1980	1985	1990	1995	2000	2003	2004	2005
A. Distribution of grants by function:												
Natural resources and environment	0.1	0.2	0.4	2.4	5.4	4.1	3.7	4.0	4.6	5.6	6.5	5.9
Agriculture	0.2	0.5	0.6	0.4	0.6	2.4	1.3	0.8	0.7	0.8	0.9	0.8
Transportation	3.0	4.1	4.6	5.9	13.0	17.0	19.2	25.8	32.2	41.0	43.5	44.9
Community and regional development	0.1	0.6	1.8	2.8	6.5	5.2	5.0	7.2	8.7	15.1	14.8	13.9
Education, training, employment, and social services	0.5	1.1	6.4	12.1	21.9	17.1	21.8	30.9	36.7	51.5	56.9	57.0
Health	0.2	0.6	3.8	8.8	15.8	24.5	43.9	93.6	124.8	173.8	191.9	197.1
Income security	2.6	3.5	5.8	9.4	18.5	27.9	36.8	58.4	68.7	86.5	88.3	88.5
Administration of Justice	....	....	*	0.7	0.5	0.1	0.6	1.2	5.3	4.5	4.3	4.3
General government	0.2	0.2	0.5	7.1	8.6	6.8	2.3	2.3	2.1	7.4	9.9	2.8
Other	0.0	0.1	0.1	0.2	0.7	0.8	0.8	0.8	0.9	1.0	1.1	1.2
Total	7.0	10.9	24.1	49.8	91.4	105.9	135.3	225.0	284.7	387.3	418.1	416.5
B. Distribution of grants by BEA category:												
Discretionary	N/A	2.9	10.2	21.0	53.3	55.5	63.3	94.0	116.7	165.1	177.6	170.9
Mandatory	N/A	8.0	13.9	28.8	38.1	50.4	72.0	131.0	168.0	222.2	240.5	245.6
Total	7.0	10.9	24.1	49.8	91.4	105.9	135.3	225.0	284.7	387.3	418.1	416.5
C. Composition:												
Current dollars:												
Payments for individuals [1]	2.5	3.7	8.7	16.8	32.6	50.1	77.3	144.4	182.6	246.6	266.1	271.2
Physical capital [1]	3.3	5.0	7.1	10.9	22.6	24.9	27.2	39.6	48.7	59.8	61.3	63.1
Other grants	1.2	2.2	8.3	22.2	36.2	30.9	30.9	41.0	53.4	80.9	90.7	82.2
Total	7.0	10.9	24.1	49.8	91.4	105.9	135.3	225.0	284.7	387.3	418.1	416.5
Percentage of total grants:												
Payments for individuals [1]	35.3%	34.1%	36.2%	33.6%	35.7%	47.3%	57.1%	64.2%	64.1%	63.7%	63.6%	65.1%
Physical capital [1]	47.3%	45.7%	29.3%	21.9%	24.7%	23.5%	20.1%	17.6%	17.1%	15.5%	14.7%	15.2%
Other grants	17.4%	20.2%	34.5%	44.5%	39.6%	29.2%	22.8%	18.2%	18.8%	20.9%	21.7%	19.7%
Total	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Constant (FY 2000) dollars:												
Payments for individuals [1]	12.0	16.9	33.5	48.0	63.9	75.0	96.6	157.6	182.6	233.6	247.2	246.8
Physical capital [1]	17.0	24.2	27.2	26.0	38.9	34.2	32.6	43.3	48.7	56.5	56.8	57.4
Other grants	10.0	15.6	44.6	83.8	89.9	53.9	42.9	47.0	53.4	72.8	80.2	71.3
Total	39.0	56.7	105.3	157.7	192.6	163.1	172.1	247.9	284.7	363.0	384.2	375.5
D. Total grants as a percent of:												
Federal outlays:												
Total	7.6%	9.2%	12.3%	15.0%	15.5%	11.2%	10.8%	14.8%	15.9%	17.9%	18.0%	17.4%
Domestic programs [2]	18.0%	18.3%	23.2%	21.7%	22.2%	18.2%	17.1%	21.6%	22.0%	23.7%	24.1%	23.2%
State and local expenditures	18.2%	19.1%	23.0%	25.7%	28.5%	21.7%	19.0%	23.2%	22.8%	26.1%	N/A	N/A
Gross domestic product	1.4%	1.6%	2.4%	3.2%	3.4%	2.6%	2.4%	3.1%	2.9%	3.6%	3.6%	3.5%
E. As a share of total State and local gross investments:												
Federal capital grants	24.6%	25.5%	25.4%	26.0%	35.4%	30.2%	21.9%	26.0%	21.9%	23.9%	N/A	N/A
State and local own-source financing	75.4%	74.5%	74.6%	74.0%	64.6%	69.8%	78.1%	74.0%	78.1%	76.1%	N/A	N/A
Total	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	N/A	N/A

N/A: Not available.

* indicates $50 million or less.

[1] Grants that are both payments for individuals and capital investment are shown under capital investment.

[2] Excludes national defense, international affairs, net interest, and undistributed offsetting receipts

Federal grants for transportation increased to $3.0 billion, or 43 percent of all Federal grants, in 1960 after initiation of aid to States to build the Interstate Highway System in the late 1950s.

By 1970 there had been significant increases in the relative amounts for education, training, employment, social services, and health (largely Medicaid).

In the early and mid-1970s, major new grants were created for natural resources and environment (construction of sewage treatment plants), community and regional development (community development block grants), and general government (general revenue sharing).

Since the late 1970s changes in the relative amounts among functions reflect steady growth of grants for health (Medicaid) and income security. The functions with the largest amount of grants are health; income security; education, training, employment, and social services; and transportation, with combined estimated grant outlays of $352.9 billion, or more than 90 percent of total grant outlays in 2003.

The increase in total outlays for grants overall since 1990 has been driven by increases in grants for health, which have increased almost four-fold from $43.9 billion in 1990 to $173.8 billion in 2003. The income security; education, training, employment, and social services; and transportation functions also increased substantially, but at a slower rate than the increase for health.

Section B of the Table shows the distribution of grants divided into mandatory and discretionary spending.

Funding required for grant programs classified as mandatory is determined in authorizing legislation. Funding levels for mandatory programs can only be changed by changing eligibility criteria or benefit formulas established in law and are usually not limited by the annual appropriations process. Outlays for mandatory grant programs were $222.2 billion in 2003. The three largest mandatory grant programs are Medicaid, with outlays of $160.8 billion in 2003, Temporary Assistance for Needy Families, $19.4 billion, and child nutrition programs, $10.7 billion.

The funding level for discretionary grant programs is determined annually through appropriations acts. Outlays for discretionary grant programs were $165.1 billion in 2003. Table 8–4 at the end of this chapter identifies discretionary and mandatory grant programs separately. For more information on the Budget Enforcement Act and these categories, see Chapter 25, “The Budget System and Concepts” in this volume.

Section C of Table 8–3 shows the composition of grants divided into three major categories: payments for individuals, grants for physical capital, and other grants.[2] Grant outlays for payments for individuals, which are mainly entitlement programs in which the Federal Government and the States share the costs, have grown significantly as a percent of total grants. They increased from 57 percent of the total in 1990 to 64 percent of the total in 2003.

These grants are distributed through State or local governments to provide cash or in-kind benefits that constitute income transfers to individuals or families. The major grant in this category is Medicaid. Temporary Assistance for Needy Families, Food Stamps administration, child nutrition programs, and housing assistance are also large grants in this category.

Grants for physical capital assist States and localities with construction and other physical capital activities. The major capital grants are for highways, but there are also grants for airports, mass transit, sewage treatment plant construction, community development, and other facilities. Grants for physical capital were almost half of total grants in 1960, shortly after grants began for construction of the Interstate Highway System. The relative share of these outlays has declined, as payments for individuals have grown. In 2003, grants for physical capital were $59.8 billion, 16 percent of total grants.

The other grants are primarily for education, training, employment, and social services. These grants were 21 percent of total grants in 2003.

Section C of Table 8–3 also shows these three categories in constant dollars. In constant 2000 dollars, total grants increased from $172.1 billion in 1990 to an estimated $363.0 billion in 2003, an average increase of 5.9 percent per year. During this same period, grants for payments to individuals increased an average of 7.0 percent per year; grants for physical capital an average of 4.3 percent per year, and other grants an average of 4.2 percent per year.

In contrast to these increases, outlays for total grants in constant 2000 dollars decreased during the 1980s, from $192.6 billion in 1980 to $172.1 billion in 1990.

Section D of this table shows grants as a percentage of Federal outlays, State and local expenditures, and gross domestic product. Grants have increased as a percentage of total Federal outlays from 11 percent in 1990 to 18 percent in 2003. Grants as a percentage of domestic programs were 24 percent in 2003. As a percentage of total State and local expenditures, grants have increased from 19 percent in 1990 to 26 percent in 2003.

Section E shows the relative contribution of physical capital grants in assisting States and localities with gross investment. Federal capital grants are estimated to be 24 percent of State and local gross investment in 2003.

[2] Certain housing grants are classified in the budget as both payments for individuals and physical capital spending. In the text and tables in this section, these grants are included in the category for physical capital spending.

OTHER INFORMATION ON FEDERAL AID TO STATE AND LOCAL GOVERNMENTS

Additional information regarding aid to State and local governments can be found elsewhere in this budget and in other documents.

Major public physical capital investment programs providing Federal grants to State and local governments are identified in Chapter 6, "Federal Investment."

Data for summary and detailed grants to State and local governments can be found in many sections of a separate budget volume entitled *Historical Tables*. Section 12 of that document is devoted exclusively to grants to State and local governments. Additional information on grants can be found in Section 6 (Composition of Federal Government Outlays); Section 9 (Federal Government Outlays for Investment: Major Physical Capital, Research and Development, and Education and Training); Section 11 (Federal Government Payments for Individuals); and Section 15 (Total (Federal and State and Local) Government Finances).

In addition to these sources, a number of other sources of information are available that use slightly different concepts of grants, provide State-by-State information, provide information on how to apply for Federal aid, or display information about audits.

The Bureau of the Census in the Department of Commerce provides data on public finances, including Federal aid to State and local governments.

The Survey of Current Business, published monthly by the Bureau of Economic Analysis in the Department of Commerce, provides data on the national income and product accounts (NIPA), a broad statistical concept encompassing the entire economy. These accounts include data on Federal grants to State and local governments. Data using the NIPA concepts appear in this volume in Chapter 13, "National Income and Product Accounts."

Federal Aid to States, a report prepared by the Bureau of the Census, shows Federal spending by State for grants for the most recently completed fiscal year.

The *Consolidated Federal Funds Report* is an annual document that shows the distribution of Federal spending by State and county areas and by local governmental jurisdictions. It is prepared by the Bureau of the Census.

The Federal Assistance Awards Data System (FAADS) provides computerized information about current grant funding. Data on all direct assistance awards are provided quarterly by the Bureau of the Census to the States and to the Congress.

The Catalog of Federal Domestic Assistance is a primary reference source for communities wishing to apply for grants and other domestic assistance. The Catalog is prepared by the General Services Administration with data collected by the Office of Management and Budget. It contains a detailed listing of grant and other assistance programs; discussions of eligibility criteria, application procedures, and estimated obligations; and related information. The Catalog is available on the Internet at *http://www.cfda.gov*.

The Federal Audit Clearinghouse maintains an online database *(http://harvester.census.gov/sac)* that provides access to summary information about audits conducted under OMB Circular A–133, "Audits to States, Local Governments, and Non-Profit Organizations." Information is available for each audited entity, including the amount of Federal money expended by program and whether there were audit findings.

DETAILED FEDERAL AID TABLE

Table 8–4, "Federal Grants to State and Local Governments-Budget Authority and Outlays," provides detailed budget authority and outlay data for grants, including proposed legislation. This table displays discretionary and mandatory grant programs separately.

Table 8–4. FEDERAL GRANTS TO STATE AND LOCAL GOVERNMENTS—BUDGET AUTHORITY AND OUTLAYS

(in millions of dollars)

Function, Category, Agency, and Program	Budget Authority			Outlays		
	2003 Actual	2004 Estimate	2005 Estimate	2003 Actual	2004 Estimate	2005 Estimate
ENERGY						
Discretionary:						
Department of Energy:						
Energy Programs:						
Energy conservation	268	271	332	260	270	289
Mandatory:						
Tennessee Valley Authority fund	329	343	364	329	343	364
Total, energy	**597**	**614**	**696**	**589**	**613**	**653**
NATURAL RESOURCES AND ENVIRONMENT						
Discretionary:						
Department of Agriculture:						
Natural Resources Conservation Service:						
Watershed rehabilitation program	....	95	–95	....	....	....
Resource conservation and development	....	....	....	1	1	1
Watershed and flood prevention operations	34	83	11	47	99	64
Forest Service:						
State and private forestry	162	182	140	154	217	179
Management of national forest lands for subsistence uses	5	6	5	5	6	5
Department of Commerce:						
National Oceanic and Atmospheric Administration:						
Operations, research, and facilities	135	135	120	83	118	109
Pacific coastal salmon recovery	129	89	100	107	330	100
Department of the Interior:						
Office of Surface Mining Reclamation and Enforcement:						
Regulation and technology	57	58	59	56	56	57
Abandoned mine reclamation fund	208	173	226	202	172	246
Bureau of Reclamation:						
Bureau of Reclamation loan subsidy	....	....	....	2	....	....
United States Fish and Wildlife Service:						
State and tribal wildlife grants	65	69	80	17	64	69
Cooperative endangered species conservation fund	80	82	90	61	87	82
Wildlife conservation and appreciation fund	....	....	....	1	....	....
Landowner incentive program	....	30	50	....	32	42
National Park Service:						
Urban park and recreation fund	....	....	....	7	26	21
National recreation and preservation	1	1	4	1	1	4
Land acquisition and State assistance	97	94	94	15	70	87
Historic preservation fund	39	40	38	39	40	38
Environmental Protection Agency:						
State and tribal assistance grants	3,835	3,877	3,232	3,684	4,039	3,575
Hazardous substance superfund	94	95	182	177	161	164
Leaking underground storage tank trust fund	61	66	64	56	77	72
Total, discretionary	**5,002**	**5,175**	**4,400**	**4,715**	**5,596**	**4,915**
Mandatory:						
Department of the Interior:						
Bureau of Land Management:						
Miscellaneous permanent payment accounts	252	286	380	251	288	375
Minerals Management Service:						
National forests fund, Payment to States	3	3	3	3	3	3
Leases of lands acquired for flood control, navigation, and allied purposes	1	2	2	1	2	2
United States Fish and Wildlife Service:						
Federal aid in wildlife restoration	234	228	238	256	227	226
Sport fish restoration	330	345	369	320	336	351
National Park Service:						
Other permanent appropriations	40	46	49	40	47	48
Departmental Management:						
Everglades watershed protection	....	....	....	....	6	....
Everglades restoration account	....	....	....	2	1	1

Table 8–4. FEDERAL GRANTS TO STATE AND LOCAL GOVERNMENTS—BUDGET AUTHORITY AND OUTLAYS—Continued

(in millions of dollars)

Function, Category, Agency, and Program	Budget Authority			Outlays		
	2003 Actual	2004 Estimate	2005 Estimate	2003 Actual	2004 Estimate	2005 Estimate
Department of the Treasury:						
Financial Management Service:						
Payment to terrestrial wildlife habitat restoration trust fund	5	5	5	5	5	5
Total, mandatory	**865**	**915**	**1,046**	**878**	**915**	**1,011**
Total, natural resources and environment	**5,867**	**6,090**	**5,446**	**5,593**	**6,511**	**5,926**
AGRICULTURE						
Discretionary:						
Department of Agriculture:						
Cooperative State Research, Education, and Extension Service:						
Extension activities	455	439	420	418	426	421
Outreach for socially disadvantaged farmers	3	6	6	3	10	9
Research and education activities	238	241	243	237	242	241
Integrated activities	15	22	39	10	13	19
Agricultural Marketing Service:						
Payments to States and possessions	1	1	1	1	1	1
Farm Service Agency:						
State mediation grants	3	3	3	3	3	4
Total, discretionary	**715**	**712**	**712**	**672**	**695**	**695**
Mandatory:						
Department of Agriculture:						
Office of the Secretary:						
Fund for rural America	....	....	....	8	14	....
Farm Service Agency:						
Commodity Credit Corporation fund	120	156	67	120	156	67
Total, mandatory	**120**	**156**	**67**	**128**	**170**	**67**
Total, agriculture	**835**	**868**	**779**	**800**	**865**	**762**
COMMERCE AND HOUSING CREDIT						
Mandatory:						
Department of Commerce:						
National Oceanic and Atmospheric Administration:						
Promote and develop fishery products and research pertaining to American fisheries	10	18	1	3	28	10
TRANSPORTATION						
Discretionary:						
Department of Transportation:						
Federal Aviation Administration:						
Grants-in-aid for airports (Airport and airway trust fund)	....	....	....	2,681	3,395	3,471
Federal Highway Administration:						
State infrastructure banks	....	....	....	7	5	3
Appalachian development highway system	187	124	....	39	169	178
Appalachian development highway system (Highway trust fund)	....	....	....	93	27	15
Federal-aid highways	....	....	....	29,960	30,380	32,309
Miscellaneous appropriations	87	4	....	136	316	225
Miscellaneous highway trust funds	283	50	....	254	345	268
Federal Motor Carrier Safety Administration:						
National motor carrier safety program	167	171	....	155	233	125
Motor carrier safety	10	....	....	1	9	....
Motor Carrier Safety Grants	....	....	225	....	....	62
Border enforcement program	....	....	....	3	13	....
National Highway Traffic Safety Administration:						
Highway traffic safety grants	213	208	439	199	219	313
Federal Railroad Administration:						
Alaska railroad rehabilitation	22	25	....	20	19	29
Railroad research and development	2	2	2	2	2	2
Federal Transit Administration:						
Research, training, and human resources	....	....	....	....	1	....
Job access and reverse commute grants	105	104	....	84	108	104
Interstate transfer grants-transit	....	....	....	9	4	3

Table 8–4. FEDERAL GRANTS TO STATE AND LOCAL GOVERNMENTS—BUDGET AUTHORITY AND OUTLAYS—Continued

(in millions of dollars)

Function, Category, Agency, and Program	Budget Authority			Outlays		
	2003 Actual	2004 Estimate	2005 Estimate	2003 Actual	2004 Estimate	2005 Estimate
Washington Metropolitan Area Transit Authority				11	9	6
Formula grants	4,773	3,766		4,393	3,963	3,379
Capital investment grants	5,861	3,189		2,636	3,993	3,400
Transit planning and research	17	17		22	–43	106
Major capital investments grants			1,563			187
Discretionary grants (Highway trust fund, mass transit account)				293	261	121
Formula Grants and Research			5,569			567
Research and Special Programs Administration:						
Pipeline safety	19	19	19	19	19	19
Total, discretionary	**11,746**	**7,679**	**7,817**	**41,017**	**43,447**	**44,892**
Mandatory:						
Department of Transportation:						
Federal Aviation Administration:						
Grants-in-aid for airports (Airport and airway trust fund)	3,379	3,381	3,501			
Federal Highway Administration:						
Federal-aid highways	29,111	33,758	33,703			
Research and Special Programs Administration:						
Emergency preparedness grants	13	13	13	12	13	13
Total, mandatory	**32,503**	**37,152**	**37,217**	**12**	**13**	**13**
Total, transportation	**44,249**	**44,831**	**45,034**	**41,029**	**43,460**	**44,905**
COMMUNITY AND REGIONAL DEVELOPMENT						
Discretionary:						
Department of Agriculture:						
Rural Development:						
Rural community advancement program	900	638	477	800	798	768
Rural Utilities Service:						
Distance learning, telemedicine, and broadband program	77	81	15	22	3	63
Rural Housing Service:						
Rural community grants			–30			–21
Rural Business—Cooperative Service:						
Rural cooperative development grants	49	64	21	29	59	23
Department of Commerce:						
Economic Development Administration:						
Economic development assistance programs	289	280	290	375	383	363
Department of Homeland Security:						
Departmental Management:						
State and local programs	3,410	3,062	2,512	550	3,583	2,967
Firefighter assistance grants	745	746	500	31	399	560
Emergency Preparedness and Response:						
Operating Expenses	621	–3			319	
Mitigation grants	169	169	170	21	74	173
Disaster Relief	1,870	1,736	1,828	7,259	2,588	2,859
Department of Housing and Urban Development:						
Public and Indian Housing Programs:						
Moving to work				1	1	
Community Planning and Development:						
Community development block grants	4,905	4,934	4,618	5,569	5,990	5,586
Urban development action grants		–30		16	10	
Community development loan guarantees subsidy	7	7		7	10	9
Brownfields redevelopment	25	25		13	20	23
Empowerment zones/enterprise communities	30	15		60	70	65
Office of Lead Hazard Control and Healthy Homes:						
Lead hazard reduction	175	174	139	91	127	134
Department of the Interior:						
Bureau of Indian Affairs:						
Operation of Indian programs	146	146	148	146	146	147
Indian guaranteed loan subsidy	5	6	6	5	6	7
Appalachian Regional Commission	64	59	59	74	88	96
Delta regional authority	8	5	2	6	12	8
Denali Commission	48	56	2	2	47	57

Table 8–4. FEDERAL GRANTS TO STATE AND LOCAL GOVERNMENTS—BUDGET AUTHORITY AND OUTLAYS—Continued

(in millions of dollars)

Function, Category, Agency, and Program	Budget Authority			Outlays		
	2003 Actual	2004 Estimate	2005 Estimate	2003 Actual	2004 Estimate	2005 Estimate
Total, discretionary	**13,543**	**12,170**	**10,757**	**15,077**	**14,733**	**13,887**
Mandatory:						
Department of Agriculture:						
Rural Housing Service:						
Rural community grants	....	20	10	....	....	21
Department of Housing and Urban Development:						
Community Planning and Development:						
Community development loan guarantees subsidy	....	26	....	....	26	....
Department of the Interior:						
Bureau of Indian Affairs:						
Indian direct loan subsidy	5	....	....	5	....	....
Total, mandatory	**5**	**46**	**10**	**5**	**26**	**21**
Total, community and regional development	**13,548**	**12,216**	**10,767**	**15,082**	**14,759**	**13,908**
EDUCATION, TRAINING, EMPLOYMENT, AND SOCIAL SERVICES						
Discretionary:						
Department of Commerce:						
National Telecommunications and Information Administration:						
Public telecommunications facilities, planning and construction	26	11	....	40	22	21
Information infrastructure grants	5	5	....	20	17	12
Department of Education:						
Office of Elementary and Secondary Education:						
Reading excellence	....	....	....	214	156	64
Indian education	116	116	116	112	121	116
Impact aid	1,181	1,222	1,222	1,103	1,331	1,224
Chicago litigation settlement	....	....	....	1	1	....
Education reform	....	....	....	206	179	....
Education for the disadvantaged	14,326	13,800	15,158	11,204	14,049	14,288
School improvement programs	7,087	6,041	5,825	5,964	8,041	6,259
Office of Innovation and Improvement:						
Innovation and improvement	....	547	610	....	27	387
Office of Safe and Drug-Free Schools:						
Safe schools and citizenship education	....	798	775	....	40	557
Office of English Language Acquisition:						
English language acquisition	578	610	622	450	677	553
Office of Special Education and Rehabilitative Services:						
Special education	9,131	11,194	11,957	8,216	8,779	10,446
Rehabilitation services and disability research	126	129	143	128	230	141
American Printing House for the Blind	16	16	16	15	22	16
Office of Vocational and Adult Education:						
Vocational and adult education	1,905	2,070	1,564	1,908	1,870	1,975
Office of Postsecondary Education:						
Higher education	374	378	378	405	509	417
Federal Student Aid:						
Student financial assistance	67	66	....	65	68	53
Institute of Education Sciences:						
Institute of education sciences	....	....	....	89	77	....
Department of Health and Human Services:						
Administration for Children and Families:						
Promoting safe and stable families	402	402	503	337	412	430
Children and families services programs	8,281	8,407	8,684	8,161	8,253	8,460
Administration on Aging:						
Aging services programs	1,309	1,374	1,376	1,309	1,313	1,376
Department of the Interior:						
Bureau of Indian Affairs:						
Operation of Indian programs	97	119	112	184	87	91
Department of Labor:						
Employment and Training Administration:						
Training and employment services	3,531	3,472	4,337	4,291	3,656	3,623
Community service employment for older Americans	100	97	97	98	107	97
Welfare to work jobs	....	–122	....	....	....	....
State unemployment insurance and employment service operations	154	142	119	167	157	190
Unemployment trust fund	1,046	1,072	325	1,071	1,071	394

Table 8–4. FEDERAL GRANTS TO STATE AND LOCAL GOVERNMENTS—BUDGET AUTHORITY AND OUTLAYS—Continued

(in millions of dollars)

Function, Category, Agency, and Program	Budget Authority			Outlays		
	2003 Actual	2004 Estimate	2005 Estimate	2003 Actual	2004 Estimate	2005 Estimate
Corporation for National and Community Service:						
Domestic volunteer service programs, operating expenses	90	90	93	81	94	86
National and community service programs, operating expenses	200	305	337	264	168	350
Corporation for Public Broadcasting:						
Corporation for Public Broadcasting	411	437	390	411	437	390
District of Columbia:						
District of Columbia Courts:						
Federal payment to the Mayor of the District of Columbia	1	....	....	1	....	....
District of Columbia General and Special Payments:						
Federal payment for resident tuition support	17	17	17	17	17	17
Federal payment for school improvement	....	40	40	....	40	40
Institute of American Indian and Alaska Native Culture and Arts:						
Payment to the institute	1	1	....	1	1	....
National Endowment for the Arts:						
National Endowment for the Arts: grants and administration	51	54	53	42	53	56
Institute of Museum and Library Services:						
Office of Museum and Library Services: grants and administration	233	250	250	239	251	236
Total, discretionary	**50,862**	**53,160**	**55,119**	**46,814**	**52,333**	**52,365**
Mandatory:						
Department of Education:						
Office of Special Education and Rehabilitative Services:						
Rehabilitation services and disability research	2,534	2,584	2,636	2,465	2,427	2,602
Department of Health and Human Services:						
Administration for Children and Families:						
Social services block grant	1,700	1,700	1,700	1,740	1,767	1,769
Children and families services programs	....	....	50	....	....	30
Department of Labor:						
Employment and Training Administration:						
Welfare to work jobs	....	....	....	312	181	2
Federal unemployment benefits and allowances	259	259	259	212	233	253
Foreign labor certification processing	....	....	6	....	....	6
Total, mandatory	**4,493**	**4,543**	**4,651**	**4,729**	**4,608**	**4,662**
Total, education, training, employment, and social services	**55,355**	**57,703**	**59,770**	**51,543**	**56,941**	**57,027**
HEALTH						
Discretionary:						
Department of Agriculture:						
Food Safety and Inspection Service:						
Salaries and expenses	43	44	45	43	44	45
Department of Health and Human Services:						
Food and Drug Administration:						
Salaries and expenses	1	1	1	1	1	1
Health Resources and Services Administration:						
Health resources and services	2,499	2,651	2,809	2,499	2,651	2,809
Centers for Disease Control and Prevention:						
Disease control, research, and training	2,056	2,735	2,676	2,603	2,377	2,423
Substance Abuse and Mental Health Services Administration:						
Substance abuse and mental health services	2,259	2,318	2,512	2,171	2,268	2,428
Departmental Management:						
General departmental management	1,791	1,692	1,603	1,198	1,775	1,558
Department of Labor:						
Occupational Safety and Health Administration:						
Salaries and expenses	102	102	96	102	102	96
Mine Safety and Health Administration:						
Salaries and expenses	8	8	8	8	8	8
Total, discretionary	**8,759**	**9,551**	**9,750**	**8,625**	**9,226**	**9,368**
Mandatory:						
Department of Health and Human Services:						
Health Resources and Services Administration:						
Health resources and services	50	50	....	14	17	....

Table 8–4. FEDERAL GRANTS TO STATE AND LOCAL GOVERNMENTS—BUDGET AUTHORITY AND OUTLAYS—Continued

(in millions of dollars)

Function, Category, Agency, and Program	Budget Authority			Outlays		
	2003 Actual	2004 Estimate	2005 Estimate	2003 Actual	2004 Estimate	2005 Estimate
Centers for Medicare and Medicaid Services:						
Grants to States for medicaid	164,663	183,054	176,514	160,805	177,407	182,170
State children's health insurance fund	5,382	3,175	4,082	4,355	5,232	5,299
State grants and demonstrations	132	117	331	15	47	304
Total, mandatory	**170,227**	**186,396**	**180,927**	**165,189**	**182,703**	**187,773**
Total, health	**178,986**	**195,947**	**190,677**	**173,814**	**191,929**	**197,141**
INCOME SECURITY						
Discretionary:						
Department of Agriculture:						
Food and Nutrition Service:						
Food donations programs	59			96		
Commodity assistance program	180	164	184	167	160	176
Special supplemental nutrition program for women, infants, and children (WIC)	4,696	4,612	4,787	4,548	4,715	4,900
Department of Health and Human Services:						
Administration for Children and Families:						
Low income home energy assistance	1,688	1,889	2,001	2,030	1,892	1,965
Refugee and entrant assistance	333	281	301	352	378	389
Payments to States for the child care and development block grant	2,079	2,080	2,093	2,313	2,230	2,161
Department of Homeland Security:						
Emergency Preparedness and Response:						
Emergency food and shelter	152	152		152	152	
Department of Housing and Urban Development:						
Public and Indian Housing Programs:						
Public housing operating fund	3,577	3,579	3,573	3,395	3,551	3,572
Drug elimination grants for low-income housing	–23		–5	222	75	
Revitalization of severely distressed public housing (HOPE VI)	570	149		555	626	699
Native Hawaiian Housing Block Grant			10			1
Public housing capital fund	2,712	2,696	2,674	3,665	3,716	3,742
Native American housing block grant	645	650	626	723	733	723
Housing certificate fund	12,295	12,554	12,621	13,451	14,641	14,615
Community Planning and Development:						
Homeless assistance grants	1,217	1,260	1,282	1,080	1,400	1,467
Home investment partnership program	1,987	2,006	2,084	1,616	1,747	1,884
Emergency food and shelter program			153			153
Housing opportunities for persons with AIDS	290	295	295	254	282	292
Rural housing and economic development	25	25		20	20	20
Samaritan housing			50			5
Housing Programs:						
Homeownership and opportunity for people everywhere grants (HOPE grants)	–6			2	2	2
Housing for persons with disabilities		250	249		252	255
Housing for the elderly	1,027	774	773	992	755	766
Department of Labor:						
Employment and Training Administration:						
State unemployment insurance and employment service operations				–3		
Unemployment trust fund	3,140	2,156	2,106	2,627	2,158	2,107
Total, discretionary	**36,643**	**35,572**	**35,857**	**38,257**	**39,485**	**39,894**
Mandatory:						
Department of Agriculture:						
Agricultural Marketing Service:						
Funds for strengthening markets, income, and supply (section 32)	1,201	1,122	772	1,253	907	821
Food and Nutrition Service:						
Food stamp program	4,266	4,276	4,355	4,162	4,381	4,344
Child nutrition programs	10,508	11,261	11,231	10,664	11,295	11,441
Department of Health and Human Services:						
Administration for Children and Families:						
Payments to States for child support enforcement and family support programs	3,845	4,413	4,026	3,788	4,098	4,219
Contingency fund	1,958	2,000				9
Payments to States for foster care and adoption assistance	6,609	6,814	6,765	6,124	6,442	6,693
Child care entitlement to States	2,733	2,710	2,710	2,876	2,859	2,710
Temporary assistance for needy families	17,009	17,609	17,148	19,352	18,866	18,354

Table 8–4. FEDERAL GRANTS TO STATE AND LOCAL GOVERNMENTS—BUDGET AUTHORITY AND OUTLAYS—Continued

(in millions of dollars)

Function, Category, Agency, and Program	Budget Authority			Outlays		
	2003 Actual	2004 Estimate	2005 Estimate	2003 Actual	2004 Estimate	2005 Estimate
Total, mandatory	**48,129**	**50,205**	**47,007**	**48,219**	**48,848**	**48,591**
Total, income security	**84,772**	**85,777**	**82,864**	**86,476**	**88,333**	**88,485**
SOCIAL SECURITY						
Mandatory:						
Social Security Administration:						
Federal disability insurance trust fund	1	28	74	2	14	51
VETERANS BENEFITS AND SERVICES						
Discretionary:						
Department of Veterans Affairs:						
Medical Programs:						
Medical care	487	529	564	403	443	475
ADMINISTRATION OF JUSTICE						
Discretionary:						
Department of Health and Human Services:						
Administration for Children and Families:						
Violent crime reduction programs	....	....	....	6	3	....
Department of Homeland Security:						
Departmental Management:						
State and local programs	....	497	500	....	124	423
Department of Housing and Urban Development:						
Fair Housing and Equal Opportunity:						
Fair housing activities	46	48	48	50	47	44
Department of Justice:						
Office of Justice Programs:						
Justice assistance	110	124	1,536	151	129	1,920
State and local law enforcement assistance	1,944	1,232	....	1,856	1,305	....
Juvenile justice programs	240	299	....	233	212	....
Community oriented policing services	978	744	44	1,148	1,271	524
Violence Against Women Office	....	365	348	....	76	207
Equal Employment Opportunity Commission:						
Salaries and expenses	33	33	33	33	33	33
Federal Drug Control Programs:						
High-intensity drug trafficking areas program	196	223	208	194	231	222
State Justice Institute: salaries and expenses	3	2	....	3	2	....
Total, discretionary	**3,550**	**3,567**	**2,717**	**3,674**	**3,433**	**3,373**
Mandatory:						
Department of Justice:						
Legal Activities and U.S. Marshals:						
Assets forfeiture fund	260	204	274	239	245	329
Office of Justice Programs:						
Crime victims fund	557	572	639	510	513	643
Department of the Treasury:						
Departmental Offices:						
Treasury forfeiture fund	75	75	....	75	75	....
Total, mandatory	**892**	**851**	**913**	**824**	**833**	**972**
Total, administration of justice	**4,442**	**4,418**	**3,630**	**4,498**	**4,266**	**4,345**
GENERAL GOVERNMENT						
Discretionary:						
Department of Health and Human Services:						
Administration for Children and Families:						
Disabled voter services	15	....	....	....	5	8
Department of the Interior:						
United States Fish and Wildlife Service:						
National wildlife refuge fund	21	21	21	21	20	21
Departmental Management:						
Payments in lieu of taxes	219	225	226	219	225	226

Table 8–4. FEDERAL GRANTS TO STATE AND LOCAL GOVERNMENTS—BUDGET AUTHORITY AND OUTLAYS—Continued

(in millions of dollars)

Function, Category, Agency, and Program	Budget Authority			Outlays		
	2003 Actual	2004 Estimate	2005 Estimate	2003 Actual	2004 Estimate	2005 Estimate
Insular Affairs:						
Trust Territory of the Pacific Islands	......	......	......	2	2	2
Department of Labor:						
Employment and Training Administration:						
Workers compensation programs	......	......	......	44	131	......
Department of the Treasury:						
Financial Management Service:						
Temporary State fiscal assistance fund	5,000	5,000	......	5,000	5,000	......
District of Columbia:						
District of Columbia Courts:						
Federal payment to the District of Columbia courts	161	167	228	116	167	221
Defender services in District of Columbia courts	17	32	42	30	32	41
Federal payment for family court act	......	......	......	10	11	......
District of Columbia General and Special Payments:						
Federal support for economic development and management reforms in the District	144	108	31	145	108	31
Federal payment for emergency planning and security cost in the District of Columbia	15	11	15	......	26	15
Election Assistance Commission:						
Election reform programs	830	1,491	40	......	2,172	185
Total, discretionary	**6,422**	**7,055**	**603**	**5,587**	**7,899**	**750**
Mandatory:						
Department of Agriculture:						
Forest Service:						
Forest Service permanent appropriations	596	366	370	374	366	370
Department of Energy:						
Energy Programs:						
Payments to States under Federal Power Act	3	3	3	6	3	3
Department of the Interior:						
Bureau of Land Management:						
Miscellaneous permanent payment accounts	......	5	5	......	5	5
Minerals Management Service:						
Mineral leasing and associated payments	948	1,099	1,124	948	1,099	1,124
Insular Affairs:						
Assistance to territories	76	76	73	76	69	73
Payments to the United States territories, fiscal assistance	95	108	108	95	108	108
Department of the Treasury:						
Alcohol and Tobacco Tax and Trade Bureau:						
Internal revenue collections for Puerto Rico	357	372	382	357	372	382
Corps of Engineers-Civil Works:						
Permanent appropriations	7	8	9	6	8	9
Total, mandatory	**2,082**	**2,037**	**2,074**	**1,862**	**2,030**	**2,074**
Total, general government	**8,504**	**9,092**	**2,677**	**7,449**	**9,929**	**2,824**
Total, Grants	**397,653**	**418,131**	**402,979**	**387,281**	**418,091**	**416,512**
Discretionary	137,997	135,441	128,628	165,101	177,560	170,903
Mandatory	259,656	282,690	274,351	222,180	240,531	245,609

APPENDIX: SELECTED GRANT DATA BY STATE

This Appendix displays State-by-State spending for the selected grant programs to State and local governments shown in the following table, "Summary of Programs by Agency, Bureau, and Program." The programs selected here cover more than 80 percent of total grant spending.

The first summary table shows the obligations for each program. The second summary table, "Summary of Programs by State," shows the amounts for each State for these programs. The individual program tables display obligations for each program on a State-by-State basis, consistent with the estimates in this budget. Each table reports the following information:

- The Federal agency that administers the program.
- The program title and number as contained in the Catalog of Federal Domestic Assistance.
- The budget account number from which the program is funded.
- Actual 2003 obligations by State, Federal territory, and Indian tribes in thousands of dollars. Undistributed obligations shown at the bottom of each page are generally project funds that are not distributed by formula, or programs for which State-by-State data are not available.
- Estimates of 2004 obligations by State from previous budget authority, from new budget authority, and total obligations.
- Estimates of 2005 obligations by State, which are also based on the 2005 budget request, unless otherwise noted.
- The percentage share of 2005 estimated program funds distributed to each State.

Table 8–5. SUMMARY OF PROGRAMS BY AGENCY, BUREAU, AND PROGRAM

(obligations in millions of dollars)

Agency, Bureau, and Program	FY 2003 (actual)	Estimated FY 2004 obligations from:			FY 2005 (estimated)
		Previous authority	New authority	Total	
Department of Agriculture, Food and Nutrition Service					
National School Lunch Program (10.555)	6,351	10	6,613	6,623	6,786
Special Supplemental Nutrition Program for Women, Infants, and Children (WIC) (10.557)	4,686	61	4,749	4,810	4,869
State Administrative Matching Grants for Food Stamp Program (10.561)	2,321	....	2,331	2,331	2,378
Department of Education, Office of Elementary and Secondary Education					
Title I Grants to Local Educational Agencies (84.010)	10,046	37	13,986	14,022	13,341
Department of Education, Office of Special Education and Rehabilitative Services					
Special Education—Grants to States (84.027)	8,246	45	10,327	10,372	11,068
Rehabilitation Services—Vocational Rehabilitation Grants to States (84.126)	2,533	....	2,584	2,584	2,698
Department of Health and Human Services, Centers for Medicare and Medicaid Services					
State Children's Health Insurance Program (93.767)	3,175	....	3,175	3,175	4,082
Grants to States for Medicaid (93.778)	169,105	....	177,232	177,232	183,303
Department of Health and Human Services, Administration for Children and Families					
Temporary Assistance for Needy Families (TANF)—Family Assistance Grants (93.558)	17,393	....	17,200	17,200	17,240
Child Support Enforcement—Federal Share of State and Local Administrative Costs and Incentives (93.563)	4,053	....	4,352	4,352	4,387
Low Income Home Energy Assistance Program (93.568)	1,788	....	1,789	1,789	1,800
Child Care and Development Block Grant (93.575)	2,086	....	2,087	2,087	2,100
Child Care and Development Fund—Mandatory (93.596a)	1,235	....	1,235	1,235	1,235
Child Care and Development Fund—Matching (93.596b)	1,482	....	1,482	1,482	1,482
Head Start (93.600)	6,667	....	6,775	6,775	6,877
Foster Care—Title IV–E (93.658)	4,573	....	4,685	4,685	4,855
Department of Housing and Urban Development, Public and Indian Housing Programs					
Public Housing Operating Fund (14.850)	3,617	4	3,579	3,583	3,573
Housing Choice Vouchers (14.871)	11,273	101	14,464	14,565	13,339
Public Housing Capital Fund (14.872)	2,783	530	2,541	3,071	2,485
Department of Housing and Urban Development, Community Planning and Development					
Community Development Block Grants—Entitlement Grants (14.218)	3,038	....	3,032	3,032	3,027
Community Development Block Grants—State and Small Cities Programs (14.228; 14.219; 14.225)	1,309	....	1,306	1,306	1,304
Department of Transportation, Federal Aviation Administration					
Airport Improvement Program (20.106)	3,286	....	3,187	3,187	3,205
Department of Transportation, Federal Highway Administration					
Highway Planning and Construction (20.205)	31,775	28,719	7,100	35,818	35,092
Department of Transportation, Federal Transit Administration					
Federal Transit Capital Investment Grants (Fixed Guideway Modernization) (20.500)	1,212	108	900	1,008	1,647
Federal Transit Urbanized Area—Formula Grants (Section 5307) (20.507)	4,184	742	2,569	3,311	1,598
Federal Transit Formula and Research Grants (Section 5307) (20.507)	....	....	....	....	2,585
Total	308,217	30,357	299,279	329,635	336,355

Table 8–6. SUMMARY OF PROGRAMS BY STATE

(obligations in millions of dollars)

State or Territory	All programs FY 2003 (actual)	Programs distributed in all years					FY 2005 Percentage of distributed total
		FY 2003 (actual)	Estimated FY 2004 obligations from:			FY 2005 (estimated)	
			Previous authority	New authority	Total		
Alabama	4,616	4,616	509	4,213	4,722	4,895	1.47
Alaska	1,383	1,383	178	1,431	1,609	1,659	0.50
Arizona	5,113	5,113	477	5,592	6,068	6,612	1.98
Arkansas	3,198	3,198	357	3,259	3,615	3,684	1.10
California	36,990	36,990	2,925	36,332	39,256	39,242	11.76
Colorado	3,005	3,005	279	2,838	3,116	3,091	0.93
Connecticut	3,744	3,744	329	3,583	3,912	3,959	1.19
Delaware	776	776	112	724	836	820	0.25
District of Columbia	1,730	1,730	163	1,480	1,643	1,793	0.54
Florida	12,946	12,946	1,065	13,198	14,263	14,730	4.42
Georgia	7,963	7,963	1,127	7,378	8,505	8,671	2.60
Hawaii	1,179	1,179	259	991	1,249	1,244	0.37
Idaho	1,206	1,206	198	1,103	1,301	1,342	0.40
Illinois	11,179	11,179	1,014	10,972	11,985	12,210	3.66
Indiana	5,473	5,473	527	5,190	5,717	6,050	1.81
Iowa	2,688	2,688	308	2,443	2,751	2,797	0.84
Kansas	2,227	2,227	357	2,027	2,384	2,400	0.72
Kentucky	4,964	4,964	377	4,682	5,059	5,047	1.51
Louisiana	5,826	5,826	616	5,264	5,879	5,951	1.78
Maine	1,852	1,852	122	1,852	1,975	1,997	0.60
Maryland	4,580	4,580	500	4,463	4,963	5,037	1.51
Massachusetts	7,676	7,676	1,162	7,661	8,823	8,527	2.56
Michigan	9,425	9,425	770	9,138	9,907	10,035	3.01
Minnesota	4,710	4,710	460	4,648	5,108	5,192	1.56
Mississippi	3,908	3,908	328	3,907	4,235	4,289	1.29
Missouri	6,136	6,136	513	5,914	6,427	6,604	1.98
Montana	1,098	1,098	222	837	1,059	1,070	0.32
Nebraska	1,664	1,664	188	1,524	1,713	1,740	0.52
Nevada	1,390	1,390	205	1,430	1,635	1,671	0.50
New Hampshire	1,107	1,107	149	995	1,144	1,153	0.35
New Jersey	7,819	7,819	854	7,421	8,275	8,438	2.53
New Mexico	2,595	2,595	225	2,647	2,872	3,013	0.90
New York	34,358	34,358	1,632	38,604	40,236	41,774	12.52
North Carolina	8,018	8,018	616	8,041	8,657	9,192	2.76
North Dakota	762	762	167	651	818	823	0.25
Ohio	11,758	11,758	1,143	11,995	13,138	13,296	3.99
Oklahoma	3,467	3,467	424	3,271	3,695	3,628	1.09
Oregon	3,387	3,387	268	3,150	3,418	3,429	1.03
Pennsylvania	13,592	13,592	1,555	13,035	14,590	14,586	4.37
Rhode Island	1,465	1,465	145	1,453	1,598	1,599	0.48
South Carolina	4,315	4,315	407	4,073	4,480	4,487	1.35
South Dakota	828	828	212	677	888	896	0.27
Tennessee	6,858	6,858	706	6,379	7,085	7,470	2.24
Texas	19,387	19,387	1,825	19,197	21,022	21,361	6.40
Utah	1,743	1,743	228	1,664	1,892	2,006	0.60
Vermont	851	851	148	785	933	935	0.28
Virginia	5,204	5,204	715	4,493	5,208	5,258	1.58
Washington	5,666	5,666	529	5,313	5,842	5,910	1.77
West Virginia	2,526	2,526	360	2,205	2,565	2,624	0.79
Wisconsin	5,221	5,221	505	4,689	5,194	5,316	1.59
Wyoming	619	619	149	505	654	647	0.19
American Samoa	40	40	11	27	38	162	0.05
Guam	134	134	8	98	106	103	0.03
Northern Mariana Islands	35	35	4	25	29	30	0.01
Puerto Rico	2,044	2,044	133	2,192	2,325	2,250	0.67
Virgin Islands	114	114	35	75	110	108	0.03
Indian Tribes	656	656	1	686	687	719	0.22
Total, programs distributed by State in all years	**303,208**	**303,208**	**28,797**	**298,418**	**327,215**	**333,571**	**100.00**
MEMORANDUM:.							
Not distributed by State in all years [1]	5,009	5,009	1,560	861	2,420	2,784	N/A
Total, including undistributed	308,217	308,217	30,357	299,279	329,635	336,355	N/A

[1] The sum of programs not distributed by State in all years.

Table 8–7. NATIONAL SCHOOL LUNCH PROGRAM (10.555)

(obligations in thousands of dollars)

State or Territory	FY 2003 Actual	Estimated FY 2004 obligations from:			FY 2005 (estimated)	FY 2005 Percentage of distributed total
		Previous authority	New authority	Total		
Alabama	124,671	201	130,695	130,896	134,127	1.98
Alaska	17,809	29	18,670	18,699	19,160	0.28
Arizona	130,074	210	136,360	136,570	139,940	2.06
Arkansas	73,292	118	76,834	76,952	78,851	1.16
California	855,095	1,380	896,415	897,795	919,955	13.56
Colorado	60,804	98	63,742	63,840	65,416	0.96
Connecticut	52,563	85	55,103	55,188	56,550	0.83
Delaware	13,064	21	13,695	13,716	14,055	0.21
District of Columbia	14,651	24	15,359	15,383	15,762	0.23
Florida	361,667	583	379,144	379,727	389,099	5.73
Georgia	244,398	394	256,208	256,602	262,935	3.87
Hawaii	28,181	45	29,543	29,588	30,318	0.45
Idaho	28,727	46	30,115	30,161	30,906	0.46
Illinois	253,486	409	265,735	266,144	272,713	4.02
Indiana	108,379	175	113,616	113,791	116,599	1.72
Iowa	52,983	85	55,543	55,628	57,002	0.84
Kansas	51,648	83	54,144	54,227	55,565	0.82
Kentucky	103,495	167	108,496	108,663	111,345	1.64
Louisiana	148,083	239	155,239	155,478	159,315	2.35
Maine	19,232	31	20,161	20,192	20,691	0.30
Maryland	80,480	130	84,369	84,499	86,584	1.28
Massachusetts	89,403	144	93,723	93,867	96,184	1.42
Michigan	162,618	262	170,476	170,738	174,952	2.58
Minnesota	79,374	128	83,210	83,338	85,394	1.26
Mississippi	107,561	173	112,759	112,932	115,719	1.71
Missouri	114,164	184	119,681	119,865	122,823	1.81
Montana	15,237	25	15,973	15,998	16,393	0.24
Nebraska	34,300	55	35,957	36,012	36,902	0.54
Nevada	35,198	57	36,899	36,956	37,868	0.56
New Hampshire	12,762	21	13,379	13,400	13,730	0.20
New Jersey	128,195	207	134,390	134,597	137,918	2.03
New Mexico	56,091	90	58,801	58,891	60,345	0.89
New York	430,872	695	451,693	452,388	463,553	6.83
North Carolina	191,341	309	200,587	200,896	205,854	3.03
North Dakota	11,087	18	11,623	11,641	11,928	0.18
Ohio	180,392	291	189,109	189,400	194,074	2.86
Oklahoma	86,918	140	91,118	91,258	93,511	1.38
Oregon	59,384	96	62,254	62,350	63,888	0.94
Pennsylvania	187,919	303	197,000	197,303	202,172	2.98
Rhode Island	18,793	30	19,701	19,731	20,218	0.30
South Carolina	110,933	179	116,294	116,473	119,347	1.76
South Dakota	17,052	27	17,876	17,903	18,345	0.27
Tennessee	127,301	205	133,453	133,658	136,957	2.02
Texas	692,848	1,117	726,328	727,445	745,400	10.98
Utah	47,752	77	50,060	50,137	51,374	0.76
Vermont	8,294	13	8,695	8,708	8,923	0.13
Virginia	114,204	184	119,723	119,907	122,866	1.81
Washington	103,915	168	108,936	109,104	111,797	1.65
West Virginia	41,463	67	43,467	43,534	44,608	0.66
Wisconsin	83,802	135	87,852	87,987	90,158	1.33
Wyoming	8,204	13	8,600	8,613	8,826	0.13
American Samoa	....	....	....	....	....	....
Guam	3,700	6	3,879	3,885	3,981	0.06
Northern Mariana Islands	....	....	....	....	....	....
Puerto Rico	114,013	184	119,522	119,706	122,661	1.81
Freely Associated States	....	....	....	....	....	....
Virgin Islands	4,256	7	4,462	4,469	4,579	0.07
Indian Tribes	....	....	....	....	....	....
Undistributed	42,581	....	....	....	....	....
DOD/AF/USMC	5,885	9	6,169	6,178	6,331	0.09
Total	**6,350,594**	**10,172**	**6,612,835**	**6,623,007**	**6,786,467**	**100.00**

Table 8–8. SPECIAL SUPPLEMENTAL NUTRITION PROGRAM FOR WOMEN, INFANTS, AND CHILDREN (WIC) (10.557)

(obligations in thousands of dollars)

State or Territory	FY 2003 Actual	Estimated FY 2004 obligations from:			FY 2005 (estimated)	FY 2005 Percentage of distributed total
		Previous authority	New authority	Total		
Alabama	76,640	1,008	76,903	77,911	79,214	1.65
Alaska	21,516	283	21,590	21,873	22,239	0.46
Arizona	84,376	1,110	84,666	85,776	87,210	1.82
Arkansas	50,831	668	51,006	51,674	52,538	1.09
California	822,231	10,815	825,055	835,870	849,840	17.70
Colorado	47,241	621	47,403	48,024	48,827	1.02
Connecticut	34,117	449	34,234	34,683	35,263	0.73
Delaware	9,841	129	9,875	10,004	10,171	0.21
District of Columbia	11,421	150	11,460	11,610	11,805	0.25
Florida	210,449	2,767	211,172	213,939	217,516	4.53
Georgia	137,624	1,810	138,096	139,906	142,246	2.96
Hawaii	29,029	382	29,129	29,511	30,004	0.62
Idaho	18,678	246	18,742	18,988	19,305	0.40
Illinois	175,951	2,314	176,555	178,869	181,860	3.79
Indiana	71,675	942	71,921	72,863	74,082	1.54
Iowa	36,606	481	36,732	37,213	37,835	0.79
Kansas	33,845	445	33,961	34,406	34,982	0.73
Kentucky	69,745	917	69,984	70,901	72,087	1.50
Louisiana	86,045	1,131	86,340	87,471	88,935	1.85
Maine	12,197	160	12,239	12,399	12,607	0.26
Maryland	55,620	731	55,811	56,542	57,488	1.20
Massachusetts	63,968	841	64,188	65,029	66,116	1.38
Michigan	121,628	1,599	122,046	123,645	125,713	2.62
Minnesota	63,690	837	63,909	64,746	65,829	1.37
Mississippi	62,324	820	62,538	63,358	64,417	1.34
Missouri	70,686	929	70,929	71,858	73,060	1.52
Montana	13,608	179	13,655	13,834	14,065	0.29
Nebraska	22,294	293	22,371	22,664	23,043	0.48
Nevada	26,181	344	26,271	26,615	27,060	0.56
New Hampshire	10,037	132	10,071	10,203	10,374	0.22
New Jersey	80,698	1,061	80,975	82,036	83,408	1.74
New Mexico	33,864	445	33,980	34,425	35,001	0.73
New York	301,729	3,968	302,765	306,733	311,862	6.49
North Carolina	118,765	1,562	119,173	120,735	122,753	2.56
North Dakota	8,770	115	8,800	8,915	9,065	0.19
Ohio	143,130	1,882	143,621	145,503	147,937	3.08
Oklahoma	50,494	664	50,667	51,331	52,190	1.09
Oregon	64,420	847	64,641	65,488	66,583	1.39
Pennsylvania	125,488	1,650	125,919	127,569	129,702	2.70
Rhode Island	14,229	187	14,278	14,465	14,707	0.31
South Carolina	60,715	798	60,923	61,721	62,754	1.31
South Dakota	12,085	159	12,126	12,285	12,491	0.26
Tennessee	93,608	1,231	93,929	95,160	96,752	2.01
Texas	444,166	5,841	445,691	451,532	459,082	9.56
Utah	33,742	444	33,858	34,302	34,875	0.73
Vermont	10,725	141	10,762	10,903	11,085	0.23
Virginia	71,465	940	71,710	72,650	73,865	1.54
Washington	99,796	1,312	100,139	101,451	103,147	2.15
West Virginia	30,661	403	30,766	31,169	31,691	0.66
Wisconsin	59,198	778	59,401	60,179	61,186	1.27
Wyoming	6,513	86	6,535	6,621	6,732	0.14
American Samoa	6,055	80	6,076	6,156	6,258	0.13
Guam	6,034	79	6,055	6,134	6,237	0.13
Northern Mariana Islands	....	....	....	....	....	....
Puerto Rico	170,024	2,236	170,608	172,844	175,734	3.66
Freely Associated States	....	....	....	....	....	....
Virgin Islands	5,490	72	5,509	5,581	5,674	0.12
Indian Tribes	43,902	577	44,053	44,630	45,376	0.94
Undistributed	15,232	....	60,055	60,055	66,650	....
Farmers' Market Nutrition Program	24,995	....	26,636	26,636	....	....
Total	**4,686,087**	**61,091**	**4,748,503**	**4,809,594**	**4,868,528**	[1] **100.00**

[1] Excludes undistributed obligations.

Table 8–9. STATE ADMINISTRATIVE MATCHING GRANTS FOR FOOD STAMP PROGRAM (10.561)

(obligations in thousands of dollars)

State or Territory	FY 2003 Actual	Estimated FY 2004 obligations from:			FY 2005 (estimated)	FY 2005 Percentage of distributed total
		Previous authority	New authority	Total		
Alabama	31,185	....	31,942	31,942	32,586	1.37
Alaska	5,517	....	5,651	5,651	5,765	0.24
Arizona	27,833	....	28,509	28,509	29,083	1.22
Arkansas	20,964	....	21,473	21,473	21,906	0.92
California	330,026	....	338,036	338,036	344,853	14.50
Colorado	24,080	....	24,665	24,665	25,162	1.06
Connecticut	22,114	....	22,651	22,651	23,108	0.97
Delaware	6,971	....	7,140	7,140	7,284	0.31
District of Columbia	11,000	....	11,267	11,267	11,494	0.48
Florida	81,445	....	83,422	83,422	85,104	3.58
Georgia	60,976	....	62,456	62,456	63,715	2.68
Hawaii	10,195	....	10,442	10,442	10,653	0.45
Idaho	7,414	....	7,594	7,594	7,747	0.33
Illinois	85,779	....	87,861	87,861	89,633	3.77
Indiana	37,777	....	38,694	38,694	39,474	1.66
Iowa	15,506	....	15,882	15,882	16,203	0.68
Kansas	12,968	....	13,283	13,283	13,551	0.57
Kentucky	26,452	....	27,094	27,094	27,640	1.16
Louisiana	40,125	....	41,099	41,099	41,928	1.76
Maine	7,029	....	7,200	7,200	7,345	0.31
Maryland	33,615	....	34,431	34,431	35,125	1.48
Massachusetts	32,326	....	33,111	33,111	33,778	1.42
Michigan	87,785	....	89,916	89,916	91,729	3.86
Minnesota	35,866	....	36,737	36,737	37,477	1.58
Mississippi	27,769	....	28,443	28,443	29,017	1.22
Missouri	40,507	....	41,490	41,490	42,327	1.78
Montana	6,308	....	6,461	6,461	6,591	0.28
Nebraska	13,903	....	14,240	14,240	14,528	0.61
Nevada	10,465	....	10,719	10,719	10,935	0.46
New Hampshire	5,199	....	5,325	5,325	5,433	0.23
New Jersey	75,094	....	76,917	76,917	78,468	3.30
New Mexico	15,479	....	15,855	15,855	16,174	0.68
New York	251,123	....	257,219	257,219	262,405	11.03
North Carolina	58,810	....	60,238	60,238	61,452	2.58
North Dakota	5,454	....	5,586	5,586	5,699	0.24
Ohio	99,512	....	101,928	101,928	103,983	4.37
Oklahoma	30,990	....	31,742	31,742	32,382	1.36
Oregon	30,506	....	31,247	31,247	31,877	1.34
Pennsylvania	127,337	....	130,428	130,428	133,058	5.60
Rhode Island	5,046	....	5,168	5,168	5,273	0.22
South Carolina	21,459	....	21,980	21,980	22,423	0.94
South Dakota	5,684	....	5,822	5,822	5,939	0.25
Tennessee	34,418	....	35,253	35,253	35,964	1.51
Texas	176,158	....	180,434	180,434	184,072	7.74
Utah	15,936	....	16,323	16,323	16,652	0.70
Vermont	5,283	....	5,411	5,411	5,520	0.23
Virginia	71,542	....	73,279	73,279	74,756	3.14
Washington	34,885	....	35,732	35,732	36,452	1.53
West Virginia	13,278	....	13,600	13,600	13,875	0.58
Wisconsin	31,002	....	31,755	31,755	32,395	1.36
Wyoming	1,907	....	1,953	1,953	1,993	0.08
American Samoa	....	....	....	....	....	....
Guam	1,806	....	1,850	1,850	1,887	0.08
Northern Mariana Islands	....	....	....	....	....	....
Puerto Rico	....	....	....	....	....	....
Freely Associated States	....	....	....	....	....	....
Virgin Islands	3,950	....	4,046	4,046	4,127	0.17
Indian Tribes	....	....	....	....	....	....
Undistributed	44,933	....	....	....	....	....
Total	**2,320,691**	....	**2,331,000**	**2,331,000**	**2,378,000**	**100.00**

Table 8–10. TITLE I GRANTS TO LOCAL EDUCATIONAL AGENCIES (84.010)

(obligations in thousands of dollars)

State or Territory	FY 2003 Actual	Estimated FY 2004 obligations from:			FY 2005 (estimated)	FY 2005 Percentage of distributed total
		Previous authority	New authority	Total		
Alabama	150,452	....	213,346	213,346	201,479	1.51
Alaska	28,146	....	36,452	36,452	34,974	0.26
Arizona	167,511	....	237,177	237,177	247,541	1.86
Arkansas	93,703	....	130,298	130,298	127,256	0.95
California	1,405,904	....	1,978,436	1,978,436	1,892,513	14.19
Colorado	92,540	....	128,577	128,577	126,089	0.95
Connecticut	99,835	....	127,858	127,858	115,294	0.86
Delaware	26,929	....	36,658	36,658	34,725	0.26
District of Columbia	34,671	....	53,716	53,716	53,082	0.40
Florida	455,647	....	633,005	633,005	629,014	4.72
Georgia	301,427	....	418,136	418,136	408,277	3.06
Hawaii	31,944	....	43,839	43,839	43,714	0.33
Idaho	32,561	....	47,697	47,697	44,923	0.34
Illinois	415,666	....	585,187	585,187	575,005	4.31
Indiana	144,991	....	192,953	192,953	186,773	1.40
Iowa	60,913	....	74,465	74,465	69,476	0.52
Kansas	71,895	....	101,029	101,029	86,418	0.65
Kentucky	145,615	....	194,667	194,667	181,101	1.36
Louisiana	206,931	....	302,924	302,924	282,102	2.12
Maine	38,100	....	55,334	55,334	47,734	0.36
Maryland	146,193	....	183,155	183,155	177,862	1.33
Massachusetts	217,287	....	301,014	301,014	242,950	1.82
Michigan	400,123	....	495,194	495,194	444,074	3.33
Minnesota	107,443	....	137,208	137,208	113,909	0.85
Mississippi	126,576	....	187,673	187,673	172,535	1.29
Missouri	161,295	....	228,225	228,225	198,318	1.49
Montana	33,654	....	47,146	47,146	43,348	0.33
Nebraska	37,507	....	55,763	55,763	51,446	0.39
Nevada	40,703	....	66,512	66,512	69,765	0.52
New Hampshire	26,130	....	34,894	34,894	31,691	0.24
New Jersey	247,508	....	321,672	321,672	283,975	2.13
New Mexico	81,575	....	124,085	124,085	120,330	0.90
New York	997,915	....	1,407,518	1,407,518	1,334,482	10.01
North Carolina	211,469	....	316,433	316,433	302,223	2.27
North Dakota	25,786	....	35,462	35,462	32,416	0.24
Ohio	333,556	....	471,188	471,188	422,846	3.17
Oklahoma	117,105	....	156,775	156,775	152,110	1.14
Oregon	93,261	....	144,514	144,514	145,692	1.09
Pennsylvania	384,201	....	516,607	516,607	466,342	3.50
Rhode Island	34,170	....	52,079	52,079	49,683	0.37
South Carolina	137,390	....	188,562	188,562	177,594	1.33
South Dakota	26,661	....	38,021	38,021	37,147	0.28
Tennessee	149,742	....	224,673	224,673	215,745	1.62
Texas	845,060	....	1,235,689	1,235,689	1,202,518	9.02
Utah	41,807	....	56,817	56,817	55,363	0.42
Vermont	21,987	....	31,922	31,922	29,975	0.22
Virginia	165,791	....	223,943	223,943	215,581	1.62
Washington	137,905	....	193,334	193,334	187,176	1.40
West Virginia	78,775	....	111,716	111,716	102,869	0.77
Wisconsin	141,283	....	182,591	182,591	173,348	1.30
Wyoming	23,559	....	34,178	34,178	31,937	0.24
American Samoa	7,453	8,122	....	8,122	8,600	0.06
Guam	6,646	7,243	....	7,243	7,669	0.06
Northern Mariana Islands	3,541	3,645	....	3,645	3,860	0.03
Puerto Rico	326,549	....	502,587	502,587	533,825	4.00
Freely Associated States	....	....	....	....	....	....
Virgin Islands	10,014	10,914	....	10,914	11,556	0.09
Indian Tribes	81,886	....	86,703	86,703	94,027	0.71
Undistributed	11,049	6,796	....	6,796	8,500	....
Total	**10,045,931**	**36,720**	**13,985,610**	**14,022,330**	**13,340,776**	[1] **100.00**

[1] Excludes undistributed obligations.

Table 8–11. SPECIAL EDUCATION—GRANTS TO STATES (84.027)

(obligations in thousands of dollars)

State or Territory	FY 2003 Actual	Estimated FY 2004 obligations from:			FY 2005 (estimated)	FY 2005 Percentage of distributed total
		Previous authority	New authority	Total		
Alabama	132,465		165,763	165,763	175,795	1.59
Alaska	24,523		31,050	31,050	33,735	0.31
Arizona	122,666		155,318	155,318	168,746	1.53
Arkansas	79,493		99,942	99,942	106,814	0.97
California	863,460		1,093,300	1,093,300	1,184,687	10.73
Colorado	103,891		131,545	131,545	142,917	1.29
Connecticut	97,637		120,579	120,579	128,204	1.16
Delaware	22,475		28,457	28,457	30,918	0.28
District of Columbia	11,300		14,309	14,309	15,546	0.14
Florida	446,581		561,838	561,838	608,918	5.51
Georgia	215,645		273,047	273,047	296,653	2.69
Hawaii	28,345		35,890	35,890	38,993	0.35
Idaho	38,148		48,302	48,302	52,445	0.47
Illinois	368,642		456,474	456,474	485,975	4.40
Indiana	187,610		233,307	233,307	248,443	2.25
Iowa	90,286		111,279	111,279	117,871	1.07
Kansas	78,114		97,410	97,410	103,387	0.94
Kentucky	114,757		142,313	142,313	150,744	1.36
Louisiana	131,869		166,971	166,971	181,406	1.64
Maine	40,467		49,876	49,876	52,831	0.48
Maryland	144,033		179,379	179,379	192,290	1.74
Massachusetts	209,933		258,744	258,744	274,072	2.48
Michigan	286,500		358,663	358,663	383,842	3.48
Minnesota	140,387		173,028	173,028	183,322	1.66
Mississippi	85,278		107,977	107,977	117,048	1.06
Missouri	167,991		207,050	207,050	219,316	1.99
Montana	26,025		32,888	32,888	35,470	0.32
Nebraska	55,222		68,061	68,061	72,093	0.65
Nevada	46,131		58,410	58,410	63,460	0.57
New Hampshire	35,097		43,257	43,257	45,819	0.41
New Jersey	267,314		329,467	329,467	348,984	3.16
New Mexico	67,392		83,272	83,272	88,633	0.80
New York	558,783		691,950	691,950	732,941	6.64
North Carolina	221,785		275,898	275,898	296,710	2.69
North Dakota	18,249		23,107	23,107	25,105	0.23
Ohio	318,655		402,336	402,336	432,818	3.92
Oklahoma	108,378		135,051	135,051	143,859	1.30
Oregon	94,676		117,926	117,926	126,626	1.15
Pennsylvania	310,967		389,947	389,947	415,615	3.76
Rhode Island	32,340		39,860	39,860	42,221	0.38
South Carolina	127,509		159,657	159,657	169,190	1.53
South Dakota	21,740		27,527	27,527	29,906	0.27
Tennessee	170,012		211,443	211,443	225,395	2.04
Texas	671,738		850,545	850,545	924,080	8.37
Utah	75,774		95,924	95,924	103,545	0.94
Vermont	17,596		22,280	22,280	24,206	0.22
Virginia	199,415		250,175	250,175	268,549	2.43
Washington	157,548		199,473	199,473	215,341	1.95
West Virginia	56,165		69,223	69,223	73,324	0.66
Wisconsin	153,874		189,763	189,763	201,192	1.82
Wyoming	18,460		23,374	23,374	25,394	0.23
American Samoa	5,950		6,471	6,471	6,269	0.06
Guam	13,180		14,349	14,349	13,901	0.13
Northern Mariana Islands	4,547		4,918	4,918	4,764	0.04
Puerto Rico	46,289	28,694	94,942	123,636	103,151	0.93
Freely Associated States						
Virgin Islands	10,902		9,120	9,120	8,835	0.08
Indian Tribes	80,459		82,101	82,101	83,210	0.75
Undistributed	21,401	16,000	22,579	38,579	22,579	
Total	**8,246,070**	**44,694**	**10,327,106**	**10,371,800**	**11,068,106**	[1] **100.00**

[1] Excludes undistributed obligations.

Table 8–12. REHABILITATION SERVICES—VOCATIONAL REHABILITATION GRANTS TO STATES (84.126)

(obligations in thousands of dollars)

State or Territory	FY 2003 Actual	Estimated FY 2004 obligations from:			FY 2005 (estimated)	FY 2005 Percentage of distributed total
		Previous authority	New authority	Total		
Alabama	52,930	....	52,957	52,957	54,942	2.04
Alaska	8,430	....	8,511	8,511	8,885	0.33
Arizona	45,401	....	48,460	48,460	51,558	1.91
Arkansas	32,324	....	33,076	33,076	34,424	1.28
California	251,750	....	243,059	243,059	255,080	9.46
Colorado	24,708	....	31,269	31,269	32,737	1.21
Connecticut	18,387	....	18,465	18,465	19,159	0.71
Delaware	8,439	....	8,511	8,511	8,885	0.33
District of Columbia	11,844	....	11,757	11,757	12,009	0.45
Florida	122,430	....	135,277	135,277	143,010	5.30
Georgia	73,729	....	76,060	76,060	79,845	2.96
Hawaii	9,662	....	10,212	10,212	10,720	0.40
Idaho	13,759	....	13,720	13,720	14,482	0.54
Illinois	91,967	....	93,294	93,294	97,110	3.60
Indiana	59,428	....	60,435	60,435	62,911	2.33
Iowa	28,603	....	29,312	29,312	30,452	1.13
Kansas	24,449	....	24,992	24,992	25,998	0.96
Kentucky	47,353	....	47,352	47,352	49,238	1.83
Louisiana	41,526	....	53,453	53,453	55,463	2.06
Maine	14,344	....	14,224	14,224	14,805	0.55
Maryland	37,535	....	37,170	37,170	38,800	1.44
Massachusetts	44,347	....	42,740	42,740	44,079	1.63
Michigan	87,351	....	87,505	87,505	90,940	3.37
Minnesota	39,813	....	39,527	39,527	41,151	1.53
Mississippi	38,113	....	38,442	38,442	39,871	1.48
Missouri	55,526	....	55,753	55,753	57,988	2.15
Montana	10,092	....	10,227	10,227	10,690	0.40
Nebraska	16,106	....	16,182	16,182	16,848	0.62
Nevada	12,774	....	14,920	14,920	16,036	0.59
New Hampshire	9,923	....	9,613	9,613	10,019	0.37
New Jersey	51,046	....	51,532	51,532	53,506	1.98
New Mexico	20,610	....	21,178	21,178	22,182	0.82
New York	132,280	....	133,309	133,309	138,051	5.12
North Carolina	77,974	....	80,859	80,859	84,503	3.13
North Dakota	8,356	....	8,511	8,511	8,885	0.33
Ohio	108,669	....	109,423	109,423	113,423	4.20
Oklahoma	37,934	....	38,443	38,443	40,029	1.48
Oregon	29,974	....	31,182	31,182	32,681	1.21
Pennsylvania	113,063	....	112,925	112,925	117,026	4.34
Rhode Island	9,218	....	9,730	9,730	10,118	0.38
South Carolina	44,993	....	45,329	45,329	47,335	1.75
South Dakota	8,473	....	8,511	8,511	8,885	0.33
Tennessee	59,032	....	59,601	59,601	62,090	2.30
Texas	184,321	....	188,050	188,050	197,934	7.34
Utah	23,143	....	23,887	23,887	25,163	0.93
Vermont	8,445	....	8,511	8,511	8,885	0.33
Virginia	58,075	....	57,310	57,310	59,978	2.22
Washington	43,424	....	43,951	43,951	46,069	1.71
West Virginia	23,879	....	23,703	23,703	24,591	0.91
Wisconsin	50,917	....	51,004	51,004	53,044	1.97
Wyoming	7,106	....	8,511	8,511	8,885	0.33
American Samoa	841	....	854	854	890	0.03
Guam	2,085	....	2,548	2,548	2,673	0.10
Northern Mariana Islands	897	....	960	960	1,029	0.04
Puerto Rico	65,404	....	65,225	65,225	67,753	2.51
Freely Associated States	....	....	....	....	....	....
Virgin Islands	1,850	....	1,838	1,838	1,902	0.07
Indian Tribes	28,436	....	30,800	30,800	32,000	1.19
Undistributed	....	....	....	....	....	....
Total	**2,533,492**	....	**2,584,162**	**2,584,162**	**2,697,645**	**100.00**

Table 8–13. STATE CHILDREN'S HEALTH INSURANCE PROGRAM (93.767)

(obligations in thousands of dollars)

State or Territory	FY 2003 Actual	Estimated FY 2004 obligations from:			FY 2005 (estimated)	FY 2005 Percentage of distributed total
		Previous authority	New authority	Total		
Alabama	51,973	....	54,679	54,679	70,302	1.72
Alaska	7,430	....	7,157	7,157	9,202	0.23
Arizona	87,709	....	87,024	87,024	111,888	2.74
Arkansas	34,154	....	35,073	35,073	45,094	1.10
California	548,808	....	533,991	533,991	686,560	16.82
Colorado	37,915	....	44,865	44,865	57,684	1.41
Connecticut	24,361	....	27,975	27,975	35,968	0.88
Delaware	8,686	....	7,817	7,817	10,050	0.25
District of Columbia	7,202	....	7,199	7,199	9,256	0.23
Florida	171,991	....	193,615	193,615	248,934	6.10
Georgia	96,977	....	103,893	103,893	133,577	3.27
Hawaii	9,648	....	9,648	9,648	12,405	0.30
Idaho	16,795	....	16,958	16,958	21,803	0.53
Illinois	132,153	....	120,970	120,970	155,533	3.81
Indiana	53,710	....	54,027	54,027	69,463	1.70
Iowa	21,368	....	19,703	19,703	25,332	0.62
Kansas	24,444	....	23,542	23,542	30,268	0.74
Kentucky	37,984	....	39,287	39,287	50,512	1.24
Louisiana	61,291	....	64,523	64,523	82,958	2.03
Maine	9,689	....	9,474	9,474	12,181	0.30
Maryland	33,648	....	36,121	36,121	46,441	1.14
Massachusetts	46,201	....	46,201	46,201	59,401	1.46
Michigan	95,696	....	89,138	89,138	114,606	2.81
Minnesota	30,626	....	30,626	30,626	39,376	0.96
Mississippi	37,673	....	36,897	36,897	47,439	1.16
Missouri	43,425	....	41,923	41,923	53,901	1.32
Montana	11,326	....	10,194	10,194	13,107	0.32
Nebraska	15,414	....	13,873	13,873	17,837	0.44
Nevada	30,436	....	31,164	31,164	40,068	0.98
New Hampshire	8,904	....	8,013	8,013	10,302	0.25
New Jersey	69,346	....	64,390	64,390	82,787	2.03
New Mexico	32,789	....	32,789	32,789	42,157	1.03
New York	227,517	....	216,456	216,456	278,301	6.82
North Carolina	81,748	....	85,754	85,754	110,255	2.70
North Dakota	5,437	....	5,437	5,437	6,990	0.17
Ohio	114,614	....	103,803	103,803	133,461	3.27
Oklahoma	44,622	....	44,622	44,622	57,371	1.41
Oregon	40,709	....	38,057	38,057	48,930	1.20
Pennsylvania	100,846	....	98,748	98,748	126,962	3.11
Rhode Island	7,319	....	7,380	7,380	9,489	0.23
South Carolina	43,402	....	43,355	43,355	55,742	1.37
South Dakota	6,152	....	5,790	5,790	7,444	0.18
Tennessee	58,354	....	57,958	57,958	74,517	1.83
Texas	311,504	....	330,852	330,852	425,381	10.42
Utah	24,694	....	24,091	24,091	30,974	0.76
Vermont	3,813	....	3,813	3,813	4,902	0.12
Virginia	53,438	....	55,715	55,715	71,634	1.75
Washington	50,326	....	50,327	50,327	64,706	1.58
West Virginia	18,551	....	18,760	18,760	24,120	0.59
Wisconsin	43,825	....	43,505	43,505	55,935	1.37
Wyoming	5,481	....	4,952	4,952	6,367	0.16
American Samoa	397	....	397	397	510	0.01
Guam	1,158	....	1,158	1,158	1,489	0.04
Northern Mariana Islands	364	....	364	364	468	0.01
Puerto Rico	30,297	....	30,297	30,297	38,953	0.95
Freely Associated States	....	....	....	....	....	....
Virgin Islands	860	....	860	860	1,106	0.03
Indian Tribes	....	....	....	....	....	....
Undistributed	....	....	....	....	....	....
Total	[1] **3,175,200**	....	**3,175,200**	[1] **3,175,200**	[1] **4,082,400**	**100.00**

[1] FY2003 and FY 2004 amounts published in FEDERAL REGISTER; FY2005 are estimates; FY2003, FY2004 and FY2005 do not include redistribution/retention amounts.

Table 8–14. GRANTS TO STATES FOR MEDICAID (93.778)

(obligations in thousands of dollars)

State or Territory	FY 2003 Actual	Estimated FY 2004 obligations from:			FY 2005 (estimated)	FY 2005 Percentage of distributed total
		Previous authority	New authority	Total		
Alabama	2,558,176	....	2,524,653	2,524,653	2,684,767	1.46
Alaska	553,188	....	806,044	806,044	831,692	0.45
Arizona	3,173,602	....	3,776,578	3,776,578	4,324,884	2.36
Arkansas	1,939,726	....	2,282,049	2,282,049	2,327,134	1.27
California	18,020,772	....	18,424,892	18,424,892	18,215,331	9.94
Colorado	1,416,384	....	1,403,569	1,403,569	1,357,010	0.74
Connecticut	1,987,481	....	2,023,038	2,023,038	2,047,094	1.12
Delaware	398,399	....	424,358	424,358	412,412	0.22
District of Columbia	932,848	....	901,172	901,172	1,000,602	0.55
Florida	7,143,923	....	7,736,075	7,736,075	8,081,629	4.41
Georgia	4,234,217	....	4,367,010	4,367,010	4,513,123	2.46
Hawaii	513,944	....	530,065	530,065	508,085	0.28
Idaho	644,996	....	703,000	703,000	724,503	0.40
Illinois	5,547,749	....	5,699,779	5,699,779	5,775,645	3.15
Indiana	3,180,739	....	3,251,085	3,251,085	3,532,269	1.93
Iowa	1,490,276	....	1,509,138	1,509,138	1,553,375	0.85
Kansas	1,196,630	....	1,247,296	1,247,296	1,272,629	0.69
Kentucky	2,842,596	....	3,018,086	3,018,086	2,997,006	1.64
Louisiana	3,623,279	....	3,506,799	3,506,799	3,591,806	1.96
Maine	1,233,265	....	1,323,762	1,323,762	1,356,687	0.74
Maryland	2,337,403	....	2,552,600	2,552,600	2,618,169	1.43
Massachusetts	4,461,971	....	5,189,325	5,189,325	4,948,076	2.70
Michigan	5,088,625	....	5,219,495	5,219,495	5,328,080	2.91
Minnesota	2,682,277	....	2,917,474	2,917,474	2,986,600	1.63
Mississippi	2,487,126	....	2,704,138	2,704,138	2,742,827	1.50
Missouri	3,730,980	....	3,885,646	3,885,646	4,045,420	2.21
Montana	504,609	....	415,473	415,473	422,539	0.23
Nebraska	903,271	....	888,012	888,012	926,841	0.51
Nevada	621,240	....	744,129	744,129	776,467	0.42
New Hampshire	634,470	....	621,318	621,318	629,925	0.34
New Jersey	4,128,343	....	4,205,878	4,205,878	4,271,380	2.33
New Mexico	1,604,749	....	1,802,300	1,802,300	1,928,522	1.05
New York	22,048,106	....	26,959,349	26,959,349	28,207,414	15.39
North Carolina	4,844,869	....	5,135,793	5,135,793	5,700,006	3.11
North Dakota	353,127	....	363,517	363,517	371,778	0.20
Ohio	6,607,667	....	7,594,403	7,594,403	7,734,778	4.22
Oklahoma	1,888,936	....	2,014,116	2,014,116	1,948,962	1.06
Oregon	1,875,631	....	1,822,753	1,822,753	1,792,902	0.98
Pennsylvania	7,671,305	....	8,311,044	8,311,044	8,179,799	4.46
Rhode Island	852,904	....	948,437	948,437	958,818	0.52
South Carolina	2,726,669	....	2,712,135	2,712,135	2,717,472	1.48
South Dakota	389,951	....	418,924	418,924	420,981	0.23
Tennessee	4,555,674	....	4,545,611	4,545,611	4,885,193	2.67
Texas	10,163,965	....	10,857,198	10,857,198	11,093,478	6.05
Utah	848,130	....	959,475	959,475	1,052,184	0.57
Vermont	496,035	....	532,772	532,772	537,317	0.29
Virginia	2,345,250	....	2,361,169	2,361,169	2,383,815	1.30
Washington	3,035,439	....	3,069,794	3,069,794	3,104,757	1.69
West Virginia	1,484,996	....	1,534,748	1,534,748	1,556,280	0.85
Wisconsin	3,016,290	....	2,855,074	2,855,074	2,961,296	1.62
Wyoming	229,004	....	243,921	243,921	234,996	0.13
American Samoa	3,727	....	3,947	3,947	3,947	*
Guam	6,591	....	6,683	6,683	6,683	*
Northern Mariana Islands	2,235	....	2,381	2,381	2,381	*
Puerto Rico	215,666	....	219,397	219,397	210,100	0.11
Freely Associated States	....	....	....	....	....	....
Virgin Islands	6,641	....	6,913	6,913	6,913	*
Indian Tribes	....	....	....	....	....	....
Undistributed	....	....	....	....	....	....
Survey and Certification	182,172	....	242,820	242,820	247,420	0.13
Fraud Control Units	120,153	....	129,000	129,000	138,500	0.08
Vaccines For Children	1,164,194	....	1,208,420	1,208,420	1,208,296	0.66
Medicare Part B Transfer	112,094	....	125,000	125,000	....	....
Medicare Part D	....	....	....	....	105,900	0.06
Adjustments	40,730	....	− 4,556,620	− 4,556,620	− 3,202,030	− 1.75
Total	**169,105,405**	....	**177,232,410**	**177,232,410**	**183,302,865**	**100.00**

* $500 or less or 0.005 percent or less.

Table 8–15. TEMPORARY ASSISTANCE FOR NEEDY FAMILIES (TANF)—FAMILY ASSISTANCE GRANTS (93.558)

(obligations in thousands of dollars)

State or Territory	FY 2003 Actual	Estimated FY 2004 obligations from:			FY 2005 (estimated)	FY 2005 Percentage of distributed total
		Previous authority	New authority	Total		
Alabama	104,914	....	104,408	104,408	104,408	0.61
Alaska	66,626	....	60,265	60,265	60,265	0.35
Arizona	227,334	....	226,131	226,131	226,131	1.31
Arkansas	68,625	....	62,951	62,951	62,951	0.37
California	3,708,706	....	3,683,469	3,683,469	3,683,469	21.37
Colorado	169,449	....	149,626	149,626	149,626	0.87
Connecticut	278,533	....	266,788	266,788	266,788	1.55
Delaware	33,545	....	32,291	32,291	32,291	0.19
District of Columbia	117,230	....	92,610	92,610	92,610	0.54
Florida	660,838	....	622,746	622,746	622,746	3.61
Georgia	372,423	....	368,025	368,025	368,025	2.13
Hawaii	99,772	....	98,905	98,905	98,905	0.57
Idaho	35,996	....	33,911	33,911	33,911	0.20
Illinois	585,057	....	585,057	585,057	585,057	3.39
Indiana	226,243	....	206,799	206,799	206,799	1.20
Iowa	138,692	....	131,525	131,525	131,525	0.76
Kansas	112,124	....	101,931	101,931	101,931	0.59
Kentucky	195,758	....	181,288	181,288	181,288	1.05
Louisiana	184,759	....	180,999	180,999	180,999	1.05
Maine	82,400	....	78,121	78,121	78,121	0.45
Maryland	250,502	....	229,098	229,098	229,098	1.33
Massachusetts	461,564	....	459,371	459,371	459,371	2.66
Michigan	797,303	....	775,353	775,353	775,353	4.50
Minnesota	280,561	....	267,161	267,161	267,161	1.55
Mississippi	96,623	....	95,803	95,803	95,803	0.56
Missouri	238,757	....	217,052	217,052	217,052	1.26
Montana	48,020	....	44,109	44,109	44,109	0.26
Nebraska	63,572	....	57,769	57,769	57,769	0.34
Nevada	49,747	....	47,710	47,710	47,710	0.28
New Hampshire	41,249	....	38,521	38,521	38,521	0.22
New Jersey	408,288	....	404,035	404,035	404,035	2.34
New Mexico	122,513	....	117,131	117,131	117,131	0.68
New York	2,466,019	....	2,442,931	2,442,931	2,442,931	14.17
North Carolina	341,867	....	338,350	338,350	338,350	1.96
North Dakota	27,682	....	26,400	26,400	26,400	0.15
Ohio	749,354	....	727,968	727,968	727,968	4.22
Oklahoma	154,110	....	147,594	147,594	147,594	0.86
Oregon	172,869	....	166,799	166,799	166,799	0.97
Pennsylvania	751,157	....	719,499	719,499	719,499	4.17
Rhode Island	97,880	....	95,022	95,022	95,022	0.55
South Carolina	101,523	....	99,968	99,968	99,968	0.58
South Dakota	22,865	....	21,280	21,280	21,280	0.12
Tennessee	224,265	....	213,089	213,089	213,089	1.24
Texas	566,538	....	538,965	538,965	538,965	3.13
Utah	90,289	....	84,314	84,314	84,314	0.49
Vermont	48,623	....	47,353	47,353	47,353	0.27
Virginia	174,114	....	158,285	158,285	158,285	0.92
Washington	401,283	....	389,069	389,069	389,069	2.26
West Virginia	113,000	....	110,176	110,176	110,176	0.64
Wisconsin	326,543	....	315,767	315,767	315,767	1.83
Wyoming	38,703	....	18,501	18,501	18,501	0.11
American Samoa	....	....	....	....	....	....
Guam	3,993	....	3,993	3,993	3,993	0.02
Northern Mariana Islands	....	....	....	....	....	....
Puerto Rico	70,000	....	71,035	71,035	71,035	0.41
Freely Associated States	....	....	....	....	....	....
Virgin Islands	3,735	....	2,847	2,847	2,847	0.02
Indian Tribes	110,823	....	125,828	125,828	125,828	0.73
Undistributed	....	....	....	....	....	....
Tribal NEW Program	7,633	....	7,633	7,633	7,633	0.04
Employment Achieve Bonus	....	....	[1] 100,000	[1] 100,000	[1] 100,000	0.58
TANF Research and Technical Assistance	....	....	[1] 100,000	[1] 100,000	[1] 120,000	0.70
Family Formation Match	....	....	[1] 100,000	[1] 100,000	[1] 120,000	0.70
Territories Matching Fund	....	....	[1] 6,000	[1] 6,000	[1] 6,000	0.03
Total	[2] **17,392,591**	....	**17,199,625**	**17,199,625**	**17,239,625**	**100.00**

[1] Distribution of obligation levels to be determined.

[2] State and Territory levels in FY 2003 reflect actual obligations, including bonus funds and Territory Matching Funds.

Table 8–16. CHILD SUPPORT ENFORCEMENT—FEDERAL SHARE OF STATE AND LOCAL ADMINISTRATIVE COSTS AND INCENTIVES (93.563)

(obligations in thousands of dollars)

State or Territory	FY 2003 Actual	Estimated FY 2004 obligations from:			FY 2005 (estimated)	FY 2005 Percentage of distributed total
		Previous authority	New authority	Total		
Alabama	42,935		46,056	46,056	46,216	1.05
Alaska	16,239		17,419	17,419	17,479	0.40
Arizona	42,329		45,405	45,405	45,563	1.04
Arkansas	39,417		42,282	42,282	42,429	0.97
California	800,415		858,595	858,595	861,571	19.64
Colorado	47,140		50,566	50,566	50,741	1.16
Connecticut	52,370		56,177	56,177	56,371	1.29
Delaware	14,121		15,147	15,147	15,200	0.35
District of Columbia	13,151		14,106	14,106	14,155	0.32
Florida	181,363		194,545	194,545	195,219	4.45
Georgia	83,397		89,458	89,458	89,769	2.05
Hawaii	7,975		8,555	8,555	8,585	0.20
Idaho	13,970		14,986	14,986	15,038	0.34
Illinois	125,504		134,626	134,626	135,092	3.08
Indiana	37,698		40,438	40,438	40,578	0.93
Iowa	37,987		40,748	40,748	40,890	0.93
Kansas	34,788		37,317	37,317	37,446	0.85
Kentucky	46,835		50,239	50,239	50,413	1.15
Louisiana	39,059		41,898	41,898	42,043	0.96
Maine	17,944		19,248	19,248	19,315	0.44
Maryland	71,791		77,009	77,009	77,276	1.76
Massachusetts	65,862		70,649	70,649	70,894	1.62
Michigan	209,155		224,357	224,357	225,135	5.13
Minnesota	114,828		123,175	123,175	123,602	2.82
Mississippi	21,255		22,800	22,800	22,879	0.52
Missouri	70,897		76,050	76,050	76,313	1.74
Montana	9,437		10,123	10,123	10,158	0.23
Nebraska	32,696		35,072	35,072	35,194	0.80
Nevada	24,114		25,867	25,867	25,956	0.59
New Hampshire	12,844		13,777	13,777	13,825	0.32
New Jersey	121,884		130,743	130,743	131,196	2.99
New Mexico	25,472		27,323	27,323	27,418	0.63
New York	223,985		240,265	240,265	241,098	5.50
North Carolina	88,587		95,026	95,026	95,356	2.17
North Dakota	8,888		9,534	9,534	9,567	0.22
Ohio	270,533		290,197	290,197	291,203	6.64
Oklahoma	41,173		44,166	44,166	44,319	1.01
Oregon	42,779		45,888	45,888	46,047	1.05
Pennsylvania	166,158		178,235	178,235	178,853	4.08
Rhode Island	7,635		8,190	8,190	8,218	0.19
South Carolina	25,162		26,991	26,991	27,085	0.62
South Dakota	7,094		7,610	7,610	7,636	0.17
Tennessee	52,181		55,973	55,973	56,167	1.28
Texas	228,843		245,476	245,476	246,327	5.62
Utah	26,012		27,902	27,902	27,999	0.64
Vermont	10,211		10,953	10,953	10,991	0.25
Virginia	71,157		76,329	76,329	76,594	1.75
Washington	109,597		117,563	117,563	117,970	2.69
West Virginia	29,017		31,126	31,126	31,233	0.71
Wisconsin	111,500		119,604	119,604	120,019	2.74
Wyoming	7,343		7,876	7,876	7,904	0.18
American Samoa						
Guam	2,863		3,071	3,071	3,082	0.07
Northern Mariana Islands						
Puerto Rico	31,198		33,466	33,466	33,582	0.77
Freely Associated States						
Virgin Islands	3,241		3,477	3,477	3,489	0.08
Indian Tribes	13,157		18,000	18,000	38,000	0.87
Undistributed						
Total	**4,053,186**		**4,351,674**	**4,351,674**	**4,386,698**	**100.00**

Table 8–17. LOW INCOME HOME ENERGY ASSISTANCE PROGRAM (93.568)

(obligations in thousands of dollars)

State or Territory	FY 2003 Actual	Estimated FY 2004 obligations from:			FY 2005 (estimated)	FY 2005 Percentage of distributed total
		Previous authority	New authority	Total		
Alabama	15,037	....	15,039	15,039	15,128	0.84
Alaska	6,462	....	8,286	8,286	8,335	0.46
Arizona	6,719	....	6,723	6,723	6,763	0.38
Arkansas	11,539	....	11,546	11,546	11,614	0.65
California	80,557	....	80,599	80,599	81,076	4.50
Colorado	28,286	....	28,278	28,278	28,446	1.58
Connecticut	36,900	....	36,922	36,922	37,142	2.06
Delaware	4,898	....	4,901	4,901	4,930	0.27
District of Columbia	5,731	....	5,734	5,734	5,768	0.32
Florida	23,922	....	23,936	23,936	24,078	1.34
Georgia	18,919	....	18,930	18,930	19,042	1.06
Hawaii	1,905	....	1,906	1,906	1,918	0.11
Idaho	10,853	....	10,844	10,844	10,909	0.61
Illinois	102,133	....	102,195	102,195	102,802	5.71
Indiana	46,236	....	46,264	46,264	46,539	2.58
Iowa	32,773	....	32,793	32,793	32,988	1.83
Kansas	15,041	....	15,050	15,050	15,139	0.84
Kentucky	24,065	....	24,079	24,079	24,222	1.35
Louisiana	15,460	....	15,469	15,469	15,561	0.86
Maine	23,032	....	23,046	23,046	23,182	1.29
Maryland	28,254	....	28,271	28,271	28,439	1.58
Massachusetts	73,783	....	73,828	73,828	74,266	4.12
Michigan	96,520	....	96,426	96,426	96,998	5.39
Minnesota	69,859	....	69,901	69,901	70,316	3.91
Mississippi	12,943	....	12,951	12,951	13,028	0.72
Missouri	40,796	....	40,821	40,821	41,063	2.28
Montana	10,982	....	10,989	10,989	11,054	0.61
Nebraska	16,204	....	16,214	16,214	16,310	0.91
Nevada	3,435	....	3,437	3,437	3,457	0.19
New Hampshire	13,971	....	13,980	13,980	14,063	0.78
New Jersey	68,352	....	68,393	68,393	68,799	3.82
New Mexico	8,470	....	8,475	8,475	8,525	0.47
New York	223,410	....	223,499	223,499	224,825	12.49
North Carolina	32,808	....	32,828	32,828	33,023	1.83
North Dakota	11,341	....	11,401	11,401	11,469	0.64
Ohio	90,352	....	90,407	90,407	90,943	5.05
Oklahoma	12,729	....	12,687	12,687	12,762	0.71
Oregon	21,757	....	21,753	21,753	21,882	1.22
Pennsylvania	120,181	....	120,254	120,254	120,967	6.72
Rhode Island	12,116	....	12,123	12,123	12,195	0.68
South Carolina	12,010	....	12,017	12,017	12,089	0.67
South Dakota	9,388	....	9,393	9,393	9,449	0.52
Tennessee	24,377	....	24,392	24,392	24,537	1.36
Texas	39,808	....	39,832	39,832	40,068	2.23
Utah	12,906	....	12,894	12,894	12,971	0.72
Vermont	10,472	....	10,478	10,478	10,540	0.59
Virginia	34,417	....	34,437	34,437	34,642	1.92
Washington	34,597	....	34,610	34,610	34,815	1.93
West Virginia	15,925	....	15,935	15,935	16,030	0.89
Wisconsin	62,883	....	62,921	62,921	63,295	3.52
Wyoming	5,186	....	5,056	5,056	5,086	0.28
American Samoa	39	....	39	39	40	*
Guam	86	....	87	87	87	*
Northern Mariana Islands	30	....	30	30	30	*
Puerto Rico	2,147	....	2,148	2,148	2,161	0.12
Freely Associated States	....	....	....	....	....	....
Virgin Islands	82	....	82	82	82	*
Indian Tribes	17,597	....	16,215	16,215	16,312	0.91
Undistributed	....	....	....	....	....	....
Discretionary Funds	27,321	....	27,338	27,338	27,500	1.53
Technical Assistance	298	....	298	298	800	0.04
Total	**1,788,300**	....	**1,789,380**	**1,789,380**	**1,800,500**	**100.00**

* $500 or less or 0.005 percent or less.

Table 8–18. CHILD CARE AND DEVELOPMENT BLOCK GRANT (93.575)

(obligations in thousands of dollars)

State or Territory	FY 2003 Actual	Estimated FY 2004 obligations from:			FY 2005 (estimated)	FY 2005 Percentage of distributed total
		Previous authority	New authority	Total		
Alabama	41,670	....	41,347	41,347	41,591	1.98
Alaska	4,235	....	4,238	4,238	4,263	0.20
Arizona	45,571	....	47,827	47,827	48,109	2.29
Arkansas	24,908	....	24,828	24,828	24,974	1.19
California	237,917	....	236,074	236,074	237,463	11.31
Colorado	23,006	....	23,901	23,901	24,042	1.14
Connecticut	15,024	....	14,833	14,833	14,921	0.71
Delaware	4,458	....	4,406	4,406	4,432	0.21
District of Columbia	3,629	....	3,420	3,420	3,440	0.16
Florida	109,500	....	113,433	113,433	114,099	5.43
Georgia	71,136	....	74,027	74,027	74,462	3.55
Hawaii	8,397	....	8,540	8,540	8,590	0.41
Idaho	11,227	....	11,282	11,282	11,348	0.54
Illinois	79,109	....	78,797	78,797	79,260	3.77
Indiana	40,065	....	40,675	40,675	40,914	1.95
Iowa	19,106	....	18,452	18,452	18,560	0.88
Kansas	19,991	....	18,817	18,817	18,927	0.90
Kentucky	35,916	....	34,866	34,866	35,071	1.67
Louisiana	49,230	....	48,317	48,317	48,601	2.31
Maine	7,746	....	7,274	7,274	7,317	0.35
Maryland	27,853	....	28,257	28,257	28,423	1.35
Massachusetts	27,872	....	26,969	26,969	27,127	1.29
Michigan	60,260	....	59,304	59,304	59,653	2.84
Minnesota	26,588	....	25,791	25,791	25,943	1.24
Mississippi	33,832	....	33,350	33,350	33,546	1.60
Missouri	39,381	....	39,718	39,718	39,951	1.90
Montana	6,162	....	5,850	5,850	5,885	0.28
Nebraska	11,821	....	11,787	11,787	11,856	0.56
Nevada	11,694	....	12,667	12,667	12,741	0.61
New Hampshire	5,121	....	4,953	4,953	4,982	0.24
New Jersey	39,225	....	38,636	38,636	38,863	1.85
New Mexico	18,864	....	18,662	18,662	18,771	0.89
New York	116,407	....	112,928	112,928	113,592	5.41
North Carolina	61,675	....	64,051	64,051	64,428	3.07
North Dakota	4,442	....	4,128	4,128	4,153	0.20
Ohio	69,277	....	69,473	69,473	69,882	3.33
Oklahoma	31,232	....	30,891	30,891	31,073	1.48
Oregon	22,218	....	22,512	22,512	22,644	1.08
Pennsylvania	65,775	....	63,999	63,999	64,375	3.07
Rhode Island	5,731	....	5,558	5,558	5,590	0.27
South Carolina	36,970	....	36,762	36,762	36,978	1.76
South Dakota	6,126	....	5,935	5,935	5,970	0.28
Tennessee	45,041	....	45,807	45,807	46,076	2.19
Texas	200,954	....	206,707	206,707	207,922	9.90
Utah	20,756	....	21,301	21,301	21,426	1.02
Vermont	3,353	....	3,160	3,160	3,178	0.15
Virginia	40,206	....	40,722	40,722	40,961	1.95
Washington	34,071	....	34,113	34,113	34,314	1.63
West Virginia	14,332	....	13,656	13,656	13,736	0.65
Wisconsin	30,894	....	30,504	30,504	30,683	1.46
Wyoming	3,196	....	3,074	3,074	3,092	0.15
American Samoa	2,646	....	2,647	2,647	2,768	0.13
Guam	3,975	....	3,977	3,977	3,961	0.19
Northern Mariana Islands	1,626	....	1,627	1,627	1,733	0.08
Puerto Rico	44,872	....	42,538	42,538	42,788	2.04
Freely Associated States	....	....	....	....	....	....
Virgin Islands	2,185	....	2,186	2,186	2,037	0.10
Indian Tribes	41,727	....	41,746	41,746	41,995	2.00
Undistributed	....	....	....	....	....	....
Technical Assistance	5,216	....	5,218	5,218	5,249	0.25
Research Set-Aside	9,935	....	9,798	9,798	10,000	0.48
Child Care Aware	994	....	994	994	1,000	0.05
Total	**2,086,346**	....	**2,087,310**	**2,087,310**	**2,099,729**	**100.00**

Table 8–19. CHILD CARE AND DEVELOPMENT FUND—MANDATORY (93.596a)

(obligations in thousands of dollars)

State or Territory	FY 2003 Actual	Estimated FY 2004 obligations from:			FY 2005 (estimated)	FY 2005 Percentage of distributed total
		Previous authority	New authority	Total		
Alabama	16,442	....	16,442	16,442	16,442	1.33
Alaska	3,545	....	3,545	3,545	3,545	0.29
Arizona	19,827	....	19,827	19,827	19,827	1.60
Arkansas	5,300	....	5,300	5,300	5,300	0.43
California	85,593	....	85,593	85,593	85,593	6.93
Colorado	10,174	....	10,174	10,174	10,174	0.82
Connecticut	18,738	....	18,738	18,738	18,738	1.52
Delaware	5,179	....	5,179	5,179	5,179	0.42
District of Columbia	4,567	....	4,567	4,567	4,567	0.37
Florida	43,027	....	43,027	43,027	43,027	3.48
Georgia	36,548	....	36,548	36,548	36,548	2.96
Hawaii	4,972	....	4,972	4,972	4,972	0.40
Idaho	2,868	....	2,868	2,868	2,868	0.23
Illinois	56,874	....	56,874	56,874	56,874	4.60
Indiana	26,182	....	26,182	26,182	26,182	2.12
Iowa	8,508	....	8,508	8,508	8,508	0.69
Kansas	9,812	....	9,812	9,812	9,812	0.79
Kentucky	16,702	....	16,702	16,702	16,702	1.35
Louisiana	13,865	....	13,865	13,865	13,865	1.12
Maine	3,019	....	3,019	3,019	3,019	0.24
Maryland	23,301	....	23,301	23,301	23,301	1.89
Massachusetts	44,973	....	44,973	44,973	44,973	3.64
Michigan	32,082	....	32,082	32,082	32,082	2.60
Minnesota	23,368	....	23,368	23,368	23,368	1.89
Mississippi	6,293	....	6,293	6,293	6,293	0.51
Missouri	24,669	....	24,669	24,669	24,669	2.00
Montana	3,191	....	3,191	3,191	3,191	0.26
Nebraska	10,595	....	10,595	10,595	10,595	0.86
Nevada	2,580	....	2,580	2,580	2,580	0.21
New Hampshire	4,582	....	4,582	4,582	4,582	0.37
New Jersey	26,374	....	26,374	26,374	26,374	2.13
New Mexico	8,308	....	8,308	8,308	8,308	0.67
New York	101,981	....	101,981	101,981	101,981	8.25
North Carolina	69,639	....	69,639	69,639	69,639	5.64
North Dakota	2,506	....	2,506	2,506	2,506	0.20
Ohio	70,125	....	70,125	70,125	70,125	5.68
Oklahoma	24,910	....	24,910	24,910	24,910	2.02
Oregon	19,409	....	19,409	19,409	19,409	1.57
Pennsylvania	55,337	....	55,337	55,337	55,337	4.48
Rhode Island	6,634	....	6,634	6,634	6,634	0.54
South Carolina	9,867	....	9,867	9,867	9,867	0.80
South Dakota	1,711	....	1,711	1,711	1,711	0.14
Tennessee	37,702	....	37,702	37,702	37,702	3.05
Texas	59,844	....	59,844	59,844	59,844	4.84
Utah	12,592	....	12,592	12,592	12,592	1.02
Vermont	3,945	....	3,945	3,945	3,945	0.32
Virginia	21,329	....	21,329	21,329	21,329	1.73
Washington	41,883	....	41,883	41,883	41,883	3.39
West Virginia	8,727	....	8,727	8,727	8,727	0.71
Wisconsin	24,511	....	24,511	24,511	24,511	1.98
Wyoming	2,815	....	2,815	2,815	2,815	0.23
American Samoa	....	....	....	....	....	....
Guam	....	....	....	....	....	....
Northern Mariana Islands	....	....	....	....	....	....
Puerto Rico	....	....	....	....	....	....
Freely Associated States	....	....	....	....	....	....
Virgin Islands	....	....	....	....	....	....
Indian Tribes	54,340	....	54,340	54,340	54,340	4.40
Undistributed	....	....	....	....	....	....
Technical Assistance	3,532	....	3,532	3,532	3,532	0.29
Total	**1,235,397**	....	**1,235,397**	**1,235,397**	**1,235,397**	**100.00**

Table 8–20. CHILD CARE AND DEVELOPMENT FUND—MATCHING (93.596b)

(obligations in thousands of dollars)

State or Territory	FY 2003 Actual	Estimated FY 2004 obligations from:			FY 2005 (estimated)	FY 2005 Percentage of distributed total
		Previous authority	New authority	Total		
Alabama	22,787	....	22,358	22,358	22,358	1.51
Alaska	3,839	....	3,807	3,807	3,807	0.26
Arizona	28,412	....	30,537	30,537	30,537	2.06
Arkansas	13,733	....	13,665	13,665	13,665	0.92
California	192,462	....	194,510	194,510	194,510	13.13
Colorado	22,479	....	23,435	23,435	23,435	1.58
Connecticut	17,446	....	17,711	17,711	17,711	1.20
Delaware	3,995	....	3,845	3,845	3,845	0.26
District of Columbia	2,458	....	2,409	2,409	2,409	0.16
Florida	74,237	....	78,288	78,288	78,288	5.28
Georgia	44,824	....	46,689	46,689	46,689	3.15
Hawaii	6,054	....	6,058	6,058	6,058	0.41
Idaho	7,394	....	7,438	7,438	7,438	0.50
Illinois	66,796	....	66,611	66,611	66,611	4.50
Indiana	32,146	....	32,397	32,397	32,397	2.19
Iowa	14,641	....	13,866	13,866	13,866	0.94
Kansas	14,336	....	13,962	13,962	13,962	0.94
Kentucky	20,211	....	18,815	18,815	18,815	1.27
Louisiana	24,393	....	23,785	23,785	23,785	1.61
Maine	5,918	....	5,340	5,340	5,340	0.36
Maryland	27,911	....	27,931	27,931	27,931	1.89
Massachusetts	30,933	....	29,583	29,583	29,583	2.00
Michigan	53,020	....	51,750	51,750	51,750	3.49
Minnesota	25,788	....	24,784	24,784	24,784	1.67
Mississippi	15,669	....	15,411	15,411	15,411	1.04
Missouri	28,791	....	27,930	27,930	27,930	1.89
Montana	4,470	....	4,163	4,163	4,163	0.28
Nebraska	8,986	....	8,784	8,784	8,784	0.59
Nevada	10,784	....	11,949	11,949	11,949	0.81
New Hampshire	6,254	....	6,055	6,055	6,055	0.41
New Jersey	43,403	....	43,455	43,455	43,455	2.93
New Mexico	10,194	....	9,979	9,979	9,979	0.67
New York	96,498	....	93,739	93,739	93,739	6.33
North Carolina	40,800	....	42,592	42,592	42,592	2.87
North Dakota	3,126	....	2,843	2,843	2,843	0.19
Ohio	58,673	....	58,044	58,044	58,044	3.92
Oklahoma	17,882	....	17,581	17,581	17,581	1.19
Oregon	17,092	....	17,186	17,186	17,186	1.16
Pennsylvania	58,864	....	56,664	56,664	56,664	3.82
Rhode Island	5,087	....	4,802	4,802	4,802	0.32
South Carolina	20,604	....	19,747	19,747	19,747	1.33
South Dakota	3,984	....	3,839	3,839	3,839	0.26
Tennessee	28,626	....	28,550	28,550	28,550	1.93
Texas	120,757	....	125,093	125,093	125,093	8.44
Utah	14,661	....	14,787	14,787	14,787	1.00
Vermont	2,899	....	2,669	2,669	2,669	0.18
Virginia	35,645	....	36,138	36,138	36,138	2.44
Washington	30,661	....	30,360	30,360	30,360	2.05
West Virginia	7,988	....	7,695	7,695	7,695	0.52
Wisconsin	27,256	....	26,364	26,364	26,364	1.78
Wyoming	2,476	....	2,350	2,350	2,350	0.16
American Samoa	....	....	....	....	....	....
Guam	....	....	....	....	....	....
Northern Mariana Islands	....	....	....	....	....	....
Puerto Rico	....	....	....	....	....	....
Freely Associated States	....	....	....	....	....	....
Virgin Islands	....	....	....	....	....	....
Indian Tribes	....	....	....	....	....	....
Undistributed	....	....	....	....	....	....
Technical Assistance	3,260	....	3,260	3,260	3,260	0.22
Total	**1,481,603**	....	**1,481,603**	**1,481,603**	**1,481,603**	**100.00**

Table 8–21. HEAD START (93.600)

(obligations in thousands of dollars)

State or Territory	FY 2003 Actual	Estimated FY 2004 obligations from:			FY 2005 (estimated)	FY 2005 Percentage of distributed total
		Previous authority	New authority	Total		
Alabama	103,588	....	105,318	105,318	106,206	1.54
Alaska	12,126	....	12,329	12,329	12,433	0.18
Arizona	100,174	....	101,846	101,846	102,705	1.49
Arkansas	62,645	....	63,691	63,691	64,228	0.93
California	811,487	....	825,026	825,026	831,978	12.10
Colorado	66,428	....	67,537	67,537	68,106	0.99
Connecticut	50,604	....	51,449	51,449	51,883	0.75
Delaware	12,537	....	12,746	12,746	12,853	0.19
District of Columbia	24,408	....	24,815	24,815	25,024	0.36
Florida	255,501	....	259,767	259,767	261,957	3.81
Georgia	163,757	....	166,491	166,491	167,895	2.44
Hawaii	22,248	....	22,620	22,620	22,811	0.33
Idaho	21,820	....	22,184	22,184	22,371	0.33
Illinois	263,047	....	267,439	267,439	269,694	3.92
Indiana	93,523	....	95,084	95,084	95,886	1.39
Iowa	50,109	....	50,945	50,945	51,374	0.75
Kansas	49,503	....	50,330	50,330	50,754	0.74
Kentucky	104,829	....	106,579	106,579	107,477	1.56
Louisiana	141,892	....	144,261	144,261	145,477	2.12
Maine	26,991	....	27,441	27,441	27,672	0.40
Maryland	75,851	....	77,118	77,118	77,768	1.13
Massachusetts	105,476	....	107,237	107,237	108,141	1.57
Michigan	228,045	....	231,852	231,852	233,807	3.40
Minnesota	70,369	....	71,544	71,544	72,147	1.05
Mississippi	157,165	....	159,789	159,789	161,136	2.34
Missouri	115,663	....	117,594	117,594	118,585	1.72
Montana	20,365	....	20,705	20,705	20,880	0.30
Nebraska	35,008	....	35,593	35,593	35,893	0.52
Nevada	23,315	....	23,704	23,704	23,904	0.35
New Hampshire	13,018	....	13,236	13,236	13,348	0.19
New Jersey	126,711	....	128,827	128,827	129,913	1.89
New Mexico	50,852	....	51,701	51,701	52,137	0.76
New York	422,350	....	429,401	429,401	433,021	6.30
North Carolina	137,403	....	139,697	139,697	140,875	2.05
North Dakota	16,697	....	16,976	16,976	17,119	0.25
Ohio	239,770	....	243,773	243,773	245,828	3.57
Oklahoma	78,784	....	80,099	80,099	80,774	1.17
Oregon	57,704	....	58,667	58,667	59,162	0.86
Pennsylvania	222,603	....	226,319	226,319	228,227	3.32
Rhode Island	21,446	....	21,804	21,804	21,988	0.32
South Carolina	80,223	....	81,562	81,562	82,250	1.20
South Dakota	18,301	....	18,607	18,607	18,764	0.27
Tennessee	116,072	....	118,010	118,010	119,005	1.73
Texas	465,422	....	473,192	473,192	477,181	6.94
Utah	36,709	....	37,322	37,322	37,637	0.55
Vermont	13,183	....	13,403	13,403	13,516	0.20
Virginia	96,214	....	97,820	97,820	98,645	1.43
Washington	98,022	....	99,659	99,659	100,499	1.46
West Virginia	49,227	....	50,049	50,049	50,471	0.73
Wisconsin	88,082	....	89,553	89,553	90,308	1.31
Wyoming	12,028	....	12,229	12,229	12,332	0.18
American Samoa	....	....	....	....	....	....
Guam	....	....	....	....	....	....
Northern Mariana Islands	....	....	....	....	....	....
Puerto Rico	243,016	....	247,073	247,073	249,156	3.62
Freely Associated States	....	....	....	....	....	....
Virgin Islands	9,992	....	10,159	10,159	10,245	0.15
Indian Tribes	183,412	....	186,474	186,474	188,046	2.73
Undistributed	....	....	....	....	....	....
Other Pacific	15,128	....	15,381	15,381	15,511	0.23
Migrant Program	260,201	....	264,545	264,545	266,775	3.88
Secretary's Reserve	10,000	....	10,000	10,000	10,000	0.15
Unallocated Expansion	....	....	64,852	64,852	64,852	0.94
State Demonstration	....	....	....	....	45,000	0.65
Technical Assistance	169,688	....	104,623	104,623	106,149	1.54
Research, Development, and Education	20,000	....	20,000	20,000	20,000	0.29
Program Support	26,051	....	26,801	26,801	26,801	0.39
Total	**6,666,783**	....	**6,774,848**	**6,774,848**	**6,876,580**	**100.00**

Table 8–22. FOSTER CARE—TITLE IV–E (93.658)

(obligations in thousands of dollars)

State or Territory	FY 2003 Actual	Estimated FY 2004 obligations from:			FY 2005 (estimated)	FY 2005 Percentage of distributed total
		Previous authority	New authority	Total		
Alabama	29,031		29,741	29,741	30,571	0.63
Alaska	10,180		10,428	10,428	10,719	0.22
Arizona	43,218		44,275	44,275	45,510	0.94
Arkansas	31,795		32,572	32,572	33,481	0.69
California	1,340,945		1,373,720	1,373,720	1,412,041	29.08
Colorado	56,438		57,817	57,817	59,430	1.22
Connecticut	31,592		32,364	32,364	33,267	0.69
Delaware	8,731		8,945	8,945	9,194	0.19
District of Columbia	24,733		25,337	25,337	26,044	0.54
Florida	97,343		99,722	99,722	102,504	2.11
Georgia	31,261		32,025	32,025	32,918	0.68
Hawaii	16,962		17,377	17,377	17,862	0.37
Idaho	6,343		6,499	6,499	6,680	0.14
Illinois	378,963		388,225	388,225	399,056	8.22
Indiana	46,230		47,360	47,360	48,682	1.00
Iowa	18,203		18,648	18,648	19,168	0.39
Kansas	26,593		27,243	27,243	28,003	0.58
Kentucky	50,285		51,514	51,514	52,951	1.09
Louisiana	51,345		52,600	52,600	54,068	1.11
Maine	31,912		32,692	32,692	33,604	0.69
Maryland	127,019		130,123	130,123	133,754	2.75
Massachusetts	76,789		78,666	78,666	80,860	1.67
Michigan	130,618		133,810	133,810	137,543	2.83
Minnesota	70,374		72,094	72,094	74,105	1.53
Mississippi	8,767		8,981	8,981	9,232	0.19
Missouri	55,859		57,224	57,224	58,820	1.21
Montana	17,415		17,841	17,841	18,339	0.38
Nebraska	21,000		21,513	21,513	22,113	0.46
Nevada	13,510		13,840	13,840	14,227	0.29
New Hampshire	15,877		16,265	16,265	16,719	0.34
New Jersey	71,418		73,163	73,163	75,205	1.55
New Mexico	19,542		20,019	20,019	20,578	0.42
New York	462,302		473,600	473,600	486,813	10.03
North Carolina	48,573		49,760	49,760	51,148	1.05
North Dakota	10,814		11,078	11,078	11,387	0.23
Ohio	232,680		238,366	238,366	245,017	5.05
Oklahoma	27,633		28,308	28,308	29,098	0.60
Oregon	36,417		37,307	37,307	38,348	0.79
Pennsylvania	272,078		278,728	278,728	286,504	5.90
Rhode Island	13,487		13,817	13,817	14,203	0.29
South Carolina	28,951		29,658	29,658	30,486	0.63
South Dakota	5,635		5,773	5,773	5,934	0.12
Tennessee	22,185		22,727	22,727	23,361	0.48
Texas	161,688		165,639	165,639	170,260	3.51
Utah	16,947		17,361	17,361	17,846	0.37
Vermont	11,181		11,454	11,454	11,774	0.24
Virginia	85,426		87,513	87,513	89,955	1.85
Washington	62,023		63,538	63,538	65,311	1.35
West Virginia	23,878		24,461	24,461	25,144	0.52
Wisconsin	62,832		64,368	64,368	66,164	1.36
Wyoming	2,604		2,667	2,667	2,742	0.06
American Samoa						
Guam						
Northern Mariana Islands						
Puerto Rico	13,821		14,159	14,159	14,553	0.30
Freely Associated States						
Virgin Islands						
Indian Tribes						
Undistributed						
Technical Assistance	11,872		12,075	12,075	15,204	0.31
New Program Option					36,600	0.75
Total	**4,573,318**		**4,685,000**	**4,685,000**	**4,855,100**	**100.00**

Table 8–23. PUBLIC HOUSING OPERATING FUND (14.850)

(obligations in thousands of dollars)

State or Territory	FY 2003 Actual	Estimated FY 2004 obligations from:			FY 2005 (estimated)	FY 2005 Percentage of distributed total
		Previous authority	New authority	Total		
Alabama	114,223	127	113,016	113,143	112,673	3.15
Alaska	7,432	8	7,353	7,361	7,331	0.21
Arizona	17,046	19	16,866	16,885	16,815	0.47
Arkansas	28,441	32	28,140	28,172	28,055	0.79
California	131,209	146	129,823	129,969	129,430	3.62
Colorado	14,666	16	14,511	14,527	14,467	0.40
Connecticut	64,914	72	64,228	64,300	64,039	1.79
Delaware	9,171	10	9,074	9,084	9,046	0.25
District of Columbia	67,178	75	66,469	66,544	66,267	1.85
Florida	112,823	126	111,631	111,757	111,292	3.11
Georgia	113,611	126	112,410	112,536	112,069	3.14
Hawaii	10,234	11	10,126	10,137	10,096	0.28
Idaho	1,232	1	1,219	1,220	1,215	0.03
Illinois	255,717	284	253,016	253,300	252,249	7.06
Indiana	42,716	48	42,264	42,312	42,136	1.18
Iowa	5,470	6	5,411	5,417	5,395	0.15
Kansas	14,700	17	14,545	14,562	14,501	0.41
Kentucky	51,879	58	51,331	51,389	51,175	1.43
Louisiana	82,701	92	81,827	81,919	81,579	2.28
Maine	8,579	10	8,489	8,499	8,463	0.24
Maryland	69,342	77	68,610	68,687	68,402	1.91
Massachusetts	98,612	109	97,570	97,679	97,274	2.72
Michigan	49,800	55	49,274	49,329	49,124	1.37
Minnesota	44,264	49	43,797	43,846	43,664	1.22
Mississippi	27,457	30	27,167	27,197	27,085	0.76
Missouri	43,572	48	43,112	43,160	42,981	1.20
Montana	3,990	4	3,948	3,952	3,936	0.11
Nebraska	10,638	12	10,525	10,537	10,493	0.29
Nevada	20,251	22	20,037	20,059	19,976	0.56
New Hampshire	7,067	8	6,993	7,001	6,971	0.20
New Jersey	156,190	173	154,540	154,713	154,071	4.31
New Mexico	8,876	10	8,782	8,792	8,756	0.25
New York	812,830	903	804,243	805,146	801,805	22.44
North Carolina	103,811	115	102,714	102,829	102,402	2.87
North Dakota	1,864	2	1,844	1,846	1,838	0.05
Ohio	148,663	165	147,092	147,257	146,646	4.10
Oklahoma	24,542	27	24,283	24,310	24,209	0.68
Oregon	17,233	19	17,051	17,070	16,999	0.48
Pennsylvania	250,449	278	247,803	248,081	247,052	6.91
Rhode Island	20,288	23	20,074	20,097	20,013	0.56
South Carolina	35,742	40	35,365	35,405	35,257	0.99
South Dakota	2,072	2	2,050	2,052	2,044	0.06
Tennessee	105,974	118	104,854	104,972	104,536	2.93
Texas	120,057	133	118,789	118,922	118,428	3.31
Utah	4,031	4	3,989	3,993	3,977	0.11
Vermont	2,613	3	2,585	2,588	2,578	0.07
Virginia	69,665	77	68,929	69,006	68,720	1.92
Washington	41,139	46	40,705	40,751	40,581	1.14
West Virginia	15,973	18	15,804	15,822	15,756	0.44
Wisconsin	16,848	19	16,670	16,689	16,620	0.47
Wyoming	1,197	1	1,185	1,186	1,181	0.03
American Samoa						
Guam	4,817	5	4,766	4,771	4,752	0.13
Northern Mariana Islands						
Puerto Rico	95,438	106	94,430	94,536	94,143	2.63
Freely Associated States						
Virgin Islands	17,676	20	17,490	17,510	17,437	0.49
Indian Tribes						
Undistributed						
Other (DOJ Anti-Drug)	9,935		9,941	9,941		
Other (Volunteer Graduate Bonus)					15,000	0.42
Total	**3,616,858**	**4,005**	**3,578,760**	**3,582,765**	**3,573,000**	**100.00**

Table 8–24. HOUSING CHOICE VOUCHERS (14.871)

(obligations in thousands of dollars)

State or Territory	FY 2003 Actual	Estimated FY 2004 obligations from:			FY 2005 (estimated)	FY 2005 Percentage of distributed total
		Previous authority	New authority	Total		
Alabama	103,670	930	133,558	134,488	122,997	0.92
Alaska	24,458	219	27,273	27,492	25,111	0.19
Arizona	131,977	1,184	143,457	144,641	132,084	0.99
Arkansas	71,003	637	90,637	91,274	83,452	0.63
California	2,322,524	20,834	2,729,567	2,750,401	2,513,289	18.84
Colorado	163,532	1,467	217,067	218,534	200,184	1.50
Connecticut	222,598	1,997	288,022	290,019	266,358	2.00
Delaware	20,804	187	30,299	30,486	27,898	0.21
District of Columbia	89,336	801	98,442	99,243	92,514	0.69
Florida	483,501	4,337	631,717	636,054	584,704	4.38
Georgia	319,537	2,866	345,818	348,684	318,402	2.39
Hawaii	74,927	672	91,200	91,872	83,970	0.63
Idaho	29,481	264	31,926	32,190	29,395	0.22
Illinois	321,510	2,884	694,001	696,885	640,868	4.80
Indiana	150,459	1,350	195,372	196,722	179,883	1.35
Iowa	77,842	698	86,776	87,474	79,959	0.60
Kansas	34,726	312	53,780	54,092	49,517	0.37
Kentucky	122,537	1,099	150,011	151,110	138,118	1.04
Louisiana	153,146	1,374	177,331	178,705	163,461	1.23
Maine	54,642	490	66,894	67,384	62,418	0.47
Maryland	258,633	2,320	338,807	341,127	310,603	2.33
Massachusetts	608,044	5,454	745,195	750,649	684,000	5.13
Michigan	233,117	2,091	276,442	278,533	254,531	1.91
Minnesota	148,186	1,329	202,706	204,035	188,335	1.41
Mississippi	69,439	623	85,148	85,771	78,397	0.59
Missouri	156,820	1,407	197,875	199,282	182,188	1.37
Montana	25,327	227	27,908	28,135	25,696	0.19
Nebraska	37,224	334	55,850	56,184	51,830	0.39
Nevada	75,222	675	94,613	95,288	87,112	0.65
New Hampshire	51,150	459	64,457	64,916	59,006	0.44
New Jersey	447,772	4,017	559,773	563,790	519,996	3.90
New Mexico	64,402	578	67,949	68,527	62,562	0.47
New York	944,701	8,477	1,491,435	1,499,912	1,376,395	10.32
North Carolina	229,356	2,057	300,183	302,240	276,144	2.07
North Dakota	21,974	197	29,396	29,593	27,065	0.20
Ohio	390,049	3,499	473,657	477,156	436,156	3.27
Oklahoma	108,159	970	123,166	124,136	113,402	0.85
Oregon	146,551	1,315	189,846	191,161	175,147	1.31
Pennsylvania	361,259	3,241	492,587	495,828	454,678	3.41
Rhode Island	47,614	427	62,435	62,862	57,485	0.43
South Carolina	100,681	903	121,211	122,114	111,601	0.84
South Dakota	21,499	193	26,076	26,269	24,009	0.18
Tennessee	139,168	1,248	160,038	161,286	147,371	1.10
Texas	691,157	6,200	881,677	887,877	812,073	6.09
Utah	56,401	506	64,173	64,679	59,694	0.45
Vermont	30,532	274	33,823	34,097	31,422	0.24
Virginia	242,970	2,180	289,581	291,761	268,288	2.01
Washington	265,949	2,386	317,621	320,007	292,952	2.20
West Virginia	48,202	432	59,734	60,166	54,999	0.41
Wisconsin	96,198	863	132,776	133,639	122,272	0.92
Wyoming	6,933	62	11,155	11,217	10,270	0.08
American Samoa	....	....	....	....	....	....
Guam	28,922	259	32,006	32,265	29,469	0.22
Northern Mariana Islands	2,023	18	2,132	2,150	1,963	0.01
Puerto Rico	140,369	1,259	161,817	163,076	150,430	1.13
Freely Associated States	....	....	....	....	....	....
Virgin Islands	4,689	42	7,470	7,512	6,877	0.05
Indian Tribes	....	....	....	....	....	....
Undistributed	....	....	....	....	....	....
Total	**11,272,902**	**101,124**	**14,463,866**	**14,564,990**	**13,339,000**	**100.00**

Table 8–25. PUBLIC HOUSING CAPITAL FUND (14.872)

(obligations in thousands of dollars)

State or Territory	FY 2003 Actual	Estimated FY 2004 obligations from:			FY 2005 (estimated)	FY 2005 Percentage of distributed total
		Previous authority	New authority	Total		
Alabama	67,454	11,237	61,586	72,823	64,603	2.60
Alaska	3,324	513	3,035	3,548	2,691	0.11
Arizona	12,229	1,767	11,165	12,932	9,899	0.40
Arkansas	26,918	5,227	24,576	29,803	26,790	1.08
California	121,953	49,108	111,344	160,452	128,719	5.18
Colorado	17,941	2,553	16,380	18,933	14,523	0.58
Connecticut	32,542	8,912	29,711	38,623	26,342	1.06
Delaware	6,470	1,017	5,907	6,924	5,237	0.21
District of Columbia	25,323	5,329	23,120	28,449	25,499	1.03
Florida	78,198	21,450	71,396	92,846	78,300	3.15
Georgia	96,559	17,204	88,159	105,363	96,163	3.87
Hawaii	16,025	2,561	14,631	17,192	20,972	0.84
Idaho	1,564	242	1,428	1,670	1,266	0.05
Illinois	205,979	52,824	188,061	240,885	184,736	7.43
Indiana	35,069	4,857	32,018	36,875	37,388	1.50
Iowa	7,648	1,175	6,983	8,158	6,191	0.25
Kansas	15,894	2,468	14,511	16,979	12,866	0.52
Kentucky	54,183	9,494	49,470	58,964	53,860	2.17
Louisiana	74,236	9,819	67,778	77,597	29,000	1.17
Maine	7,377	1,132	6,735	7,867	5,972	0.24
Maryland	46,232	6,159	42,210	48,369	34,000	1.37
Massachusetts	76,284	13,246	69,648	82,894	73,751	2.97
Michigan	49,572	10,759	45,260	56,019	48,628	1.96
Minnesota	42,058	6,528	38,399	44,927	48,045	1.93
Mississippi	28,426	4,399	25,953	30,352	32,910	1.32
Missouri	45,478	7,149	41,522	48,671	47,814	1.92
Montana	4,077	633	3,722	4,355	3,300	0.13
Nebraska	11,757	1,852	10,734	12,586	12,517	0.50
Nevada	9,314	1,473	8,504	9,977	9,040	0.36
New Hampshire	7,191	1,086	6,565	7,651	7,221	0.29
New Jersey	101,377	15,784	92,558	108,342	96,063	3.87
New Mexico	9,854	1,395	8,997	10,392	9,977	0.40
New York	483,291	86,955	441,249	528,204	391,215	15.74
North Carolina	66,776	10,590	60,967	71,557	25,271	1.02
North Dakota	3,078	471	2,810	3,281	3,392	0.14
Ohio	121,511	22,760	110,941	133,701	110,361	4.44
Oklahoma	23,192	3,574	21,175	24,749	18,774	0.76
Oregon	14,208	2,164	12,972	15,136	16,501	0.66
Pennsylvania	188,015	39,003	171,660	210,663	169,195	6.81
Rhode Island	18,333	2,838	16,738	19,576	14,840	0.60
South Carolina	28,590	4,105	26,103	30,208	27,143	1.09
South Dakota	3,645	402	3,328	3,730	2,951	0.12
Tennessee	76,584	9,698	69,922	79,620	72,993	2.94
Texas	113,289	17,819	103,434	121,253	105,705	4.25
Utah	3,998	612	3,650	4,262	3,236	0.13
Vermont	2,714	422	2,478	2,900	5,197	0.21
Virginia	40,839	7,004	37,286	44,290	33,058	1.33
Washington	39,056	5,175	35,659	40,834	40,615	1.63
West Virginia	13,087	255	11,949	12,204	10,594	0.43
Wisconsin	23,942	3,625	21,859	25,484	25,381	1.02
Wyoming	1,414	219	1,291	1,510	1,145	0.05
American Samoa	....	....	....	....	....	....
Guam	1,578	254	1,441	1,695	1,277	0.05
Northern Mariana Islands	....	....	....	....	....	....
Puerto Rico	169,202	31,432	154,483	185,915	144,966	5.83
Freely Associated States	....	....	....	....	....	....
Virgin Islands	8,413	1,608	7,681	9,289	6,810	0.27
Indian Tribes	....	....	....	....	....	....
Undistributed	....	....	....	....	....	....
Total	**2,783,261**	**530,337**	**2,541,145**	[1] **3,071,482**	[1] **2,484,900**	**100.00**

[1] FY 2004 and FY 2005 estimates are projected formula grant estimates only.

Table 8–26. COMMUNITY DEVELOPMENT BLOCK GRANTS—ENTITLEMENT GRANTS (14.218)

(obligations in thousands of dollars)

State or Territory	FY 2003 Actual	Estimated FY 2004 obligations from:			FY 2005 (estimated)	FY 2005 Percentage of distributed total
		Previous authority	New authority	Total		
Alabama	28,388		28,006	28,006	27,961	0.92
Alaska	2,330		2,590	2,590	2,586	0.09
Arizona	49,758		49,134	49,134	49,055	1.62
Arkansas	9,219		9,732	9,732	9,716	0.32
California	510,439		503,834	503,834	503,024	16.62
Colorado	31,986		31,910	31,910	31,859	1.05
Connecticut	33,862		33,348	33,348	33,294	1.10
Delaware	6,343		6,213	6,213	6,203	0.20
District of Columbia	22,864		22,462	22,462	22,426	0.74
Florida	157,879		155,775	155,775	155,525	5.14
Georgia	48,476		50,434	50,434	50,353	1.66
Hawaii	12,102		11,856	11,856	11,837	0.39
Idaho	2,831		3,593	3,593	3,587	0.12
Illinois	170,232		169,177	169,177	168,905	5.58
Indiana	43,475		45,628	45,628	45,555	1.51
Iowa	16,751		17,230	17,230	17,202	0.57
Kansas	12,697		12,588	12,588	12,568	0.42
Kentucky	21,225		21,854	21,854	21,819	0.72
Louisiana	39,709		39,027	39,027	38,964	1.29
Maine	5,913		6,375	6,375	6,365	0.21
Maryland	57,354		56,849	56,849	56,758	1.88
Massachusetts	90,541		89,132	89,132	88,989	2.94
Michigan	113,413		112,847	112,847	112,666	3.72
Minnesota	44,703		44,133	44,133	44,062	1.46
Mississippi	6,087		5,906	5,906	5,897	0.19
Missouri	50,885		51,904	51,904	51,821	1.71
Montana	2,786		2,752	2,752	2,748	0.09
Nebraska	8,459		8,246	8,246	8,233	0.27
Nevada	19,897		20,341	20,341	20,308	0.67
New Hampshire	4,786		4,700	4,700	4,692	0.16
New Jersey	110,977		109,717	109,717	109,541	3.62
New Mexico	7,635		7,993	7,993	7,980	0.26
New York	362,127		358,080	358,080	357,505	11.81
North Carolina	31,423		30,932	30,932	30,882	1.02
North Dakota	1,812		1,754	1,754	1,751	0.06
Ohio	133,586		133,989	133,989	133,774	4.42
Oklahoma	16,030		15,642	15,642	15,617	0.52
Oregon	26,291		26,272	26,272	26,230	0.87
Pennsylvania	205,139		202,676	202,676	202,350	6.69
Rhode Island	14,427		14,110	14,110	14,087	0.47
South Carolina	17,959		17,760	17,760	17,731	0.59
South Dakota	1,616		1,576	1,576	1,573	0.05
Tennessee	27,539		27,611	27,611	27,567	0.91
Texas	215,906		213,920	213,920	213,576	7.06
Utah	15,507		16,464	16,464	16,438	0.54
Vermont	1,064		1,044	1,044	1,042	0.03
Virginia	47,100		49,391	49,391	49,312	1.63
Washington	54,040		53,927	53,927	53,840	1.78
West Virginia	8,566		9,654	9,654	9,638	0.32
Wisconsin	44,809		45,254	45,254	45,181	1.49
Wyoming	1,221		1,214	1,214	1,212	0.04
American Samoa						
Guam						
Northern Mariana Islands						
Puerto Rico	67,513		75,036	75,036	74,915	2.48
Freely Associated States						
Virgin Islands						
Indian Tribes						
Undistributed						
Total	[1] **3,037,677**		**3,031,592**	[1] **3,031,592**	[1] **3,026,721**	**100.00**

[1] Represents budget authority, not obligations.

Table 8–27. COMMUNITY DEVELOPMENT BLOCK GRANTS—STATE AND SMALL CITIES PROGRAMS (14.228; 14.219; 14.225)

(obligations in thousands of dollars)

State or Territory	FY 2003 Actual	Estimated FY 2004 obligations from:			FY 2005 (estimated)	FY 2005 Percentage of distributed total
		Previous authority	New authority	Total		
Alabama	29,135	....	30,041	30,041	29,993	2.30
Alaska	3,465	....	2,955	2,955	2,950	0.23
Arizona	13,633	....	14,405	14,405	14,382	1.10
Arkansas	22,489	....	22,524	22,524	22,488	1.72
California	50,812	....	49,910	49,910	49,830	3.82
Colorado	12,778	....	13,006	13,006	12,985	1.00
Connecticut	15,532	....	15,863	15,863	15,838	1.21
Delaware	2,204	....	2,296	2,296	2,292	0.18
District of Columbia	....	....	....	....	....	....
Florida	32,872	....	33,334	33,334	33,281	2.55
Georgia	47,908	....	47,120	47,120	47,045	3.61
Hawaii	5,887	....	6,137	6,137	6,127	0.47
Idaho	10,945	....	10,549	10,549	10,532	0.81
Illinois	37,834	....	37,843	37,843	37,783	2.90
Indiana	38,007	....	36,841	36,841	36,782	2.82
Iowa	30,909	....	30,975	30,975	30,925	2.37
Kansas	19,876	....	20,158	20,158	20,126	1.54
Kentucky	31,789	....	31,819	31,819	31,768	2.44
Louisiana	33,057	....	34,124	34,124	34,069	2.61
Maine	16,845	....	16,856	16,856	16,829	1.29
Maryland	9,391	....	9,358	9,358	9,343	0.72
Massachusetts	39,743	....	40,542	40,542	40,477	3.10
Michigan	42,587	....	42,906	42,906	42,837	3.28
Minnesota	23,763	....	24,291	24,291	24,252	1.86
Mississippi	34,156	....	35,330	35,330	35,274	2.70
Missouri	29,327	....	28,398	28,398	28,353	2.17
Montana	7,844	....	8,012	8,012	7,999	0.61
Nebraska	14,448	....	14,711	14,711	14,687	1.13
Nevada	3,661	....	3,176	3,176	3,171	0.24
New Hampshire	10,516	....	10,765	10,765	10,748	0.82
New Jersey	9,743	....	9,403	9,403	9,388	0.72
New Mexico	16,723	....	16,626	16,626	16,599	1.27
New York	57,312	....	57,279	57,279	57,187	4.39
North Carolina	50,688	....	52,454	52,454	52,370	4.02
North Dakota	5,630	....	5,717	5,717	5,708	0.44
Ohio	57,188	....	57,073	57,073	56,982	4.37
Oklahoma	19,751	....	20,040	20,040	20,008	1.53
Oregon	16,625	....	16,683	16,683	16,656	1.28
Pennsylvania	58,836	....	59,972	59,972	59,876	4.59
Rhode Island	6,023	....	6,156	6,156	6,146	0.47
South Carolina	27,036	....	27,821	27,821	27,777	2.13
South Dakota	7,641	....	7,774	7,774	7,762	0.60
Tennessee	30,930	....	31,243	31,243	31,193	2.39
Texas	85,241	....	86,718	86,718	86,579	6.64
Utah	8,521	....	7,526	7,526	7,514	0.58
Vermont	8,525	....	8,692	8,692	8,678	0.67
Virginia	24,352	....	22,736	22,736	22,700	1.74
Washington	18,938	....	18,647	18,647	18,617	1.43
West Virginia	20,358	....	19,912	19,912	19,880	1.52
Wisconsin	33,160	....	33,073	33,073	33,020	2.53
Wyoming	3,673	....	3,754	3,754	3,748	0.29
American Samoa	1,022	....	1,023	1,023	1,021	0.08
Guam	2,761	....	2,763	2,763	2,759	0.21
Northern Mariana Islands	1,234	....	1,235	1,235	1,233	0.09
Puerto Rico	63,554	....	55,710	55,710	55,621	4.26
Freely Associated States	....	....	....	....	....	....
Virgin Islands	1,937	....	1,938	1,938	1,935	0.15
Indian Tribes	....	....	....	....	....	....
Undistributed	....	....	....	....	....	....
Total	[1] **1,308,815**	....	**1,306,213**	[1] **1,306,213**	[1] **1,304,125**	**100.00**

[1] Represents budget authority, not obligations.

Table 8–28. AIRPORT IMPROVEMENT PROGRAM (20.106)

(obligations in thousands of dollars)

State or Territory	FY 2003 Actual	Estimated FY 2004 obligations from:			FY 2005 (estimated)	FY 2005 Percentage of distributed total
		Previous authority	New authority	Total		
Alabama	56,304		74,472	74,472	75,297	2.40
Alaska	190,981		148,861	148,861	150,511	4.80
Arizona	43,901		100,814	100,814	101,931	3.25
Arkansas	34,065		41,060	41,060	41,515	1.32
California	274,283		269,772	269,772	272,762	8.70
Colorado	81,512		75,519	75,519	76,356	2.44
Connecticut	8,227		17,485	17,485	17,679	0.56
Delaware	4,873		6,806	6,806	6,881	0.22
District of Columbia	377		1,194	1,194	1,208	0.04
Florida	185,422		165,140	165,140	166,970	5.33
Georgia	133,931		76,618	76,618	77,467	2.47
Hawaii	50,159		58,832	58,832	59,484	1.90
Idaho	18,013		21,874	21,874	22,117	0.71
Illinois	108,799		95,638	95,638	96,698	3.08
Indiana	44,849		52,449	52,449	53,031	1.69
Iowa	34,181		43,693	43,693	44,177	1.41
Kansas	25,747		16,020	16,020	16,197	0.52
Kentucky	100,299		48,825	48,825	49,366	1.57
Louisiana	59,366		49,377	49,377	49,924	1.59
Maine	23,052		6,126	6,126	6,194	0.20
Maryland	24,037		35,546	35,546	35,939	1.15
Massachusetts	39,483		45,896	45,896	46,405	1.48
Michigan	61,914		94,635	94,635	95,684	3.05
Minnesota	61,629		81,375	81,375	82,276	2.62
Mississippi	41,048		31,398	31,398	31,745	1.01
Missouri	72,558		49,026	49,026	49,569	1.58
Montana	36,823		34,133	34,133	34,511	1.10
Nebraska	32,396		31,847	31,847	32,200	1.03
Nevada	45,416		90,092	90,092	91,090	2.91
New Hampshire	19,217		27,982	27,982	28,292	0.90
New Jersey	31,563		39,804	39,804	40,245	1.28
New Mexico	30,363		12,153	12,153	12,288	0.39
New York	178,417		139,453	139,453	140,998	4.50
North Carolina	61,405		49,470	49,470	50,018	1.60
North Dakota	21,633		16,838	16,838	17,024	0.54
Ohio	83,257		110,897	110,897	112,126	3.58
Oklahoma	43,965		27,747	27,747	28,054	0.89
Oregon	40,528		47,620	47,620	48,148	1.54
Pennsylvania	98,311		102,447	102,447	103,582	3.30
Rhode Island	7,570		10,521	10,521	10,637	0.34
South Carolina	30,989		36,662	36,662	37,069	1.18
South Dakota	20,441		16,268	16,268	16,449	0.52
Tennessee	54,141		65,765	65,765	66,493	2.12
Texas	213,463		178,968	178,968	180,951	5.77
Utah	41,093		37,675	37,675	38,092	1.21
Vermont	4,026		7,233	7,233	7,313	0.23
Virginia	62,128		97,417	97,417	98,497	3.14
Washington	108,880		71,495	71,495	72,287	2.31
West Virginia	29,090		22,136	22,136	22,381	0.71
Wisconsin	39,866		38,918	38,918	39,350	1.25
Wyoming	27,714		30,443	30,443	30,780	0.98
American Samoa	5,356		8,547	8,547	8,642	0.28
Guam	23,303		9,299	9,299	9,402	0.30
Northern Mariana Islands	15,222		11,150	11,150	11,274	0.36
Puerto Rico	11,716		8,592	8,592	8,687	0.28
Freely Associated States						
Virgin Islands	5,314		11,089	11,089	11,212	0.36
Indian Tribes						
Undistributed	83,072		85,745	85,745	69,302	
Total	[1] **3,285,688**		**3,186,858**	[1] **3,186,858**	[1] **3,204,778**	[2] **100.00**

[1] Excludes state block grants.
[2] Excludes undistributed obligations.

Table 8–29. HIGHWAY PLANNING AND CONSTRUCTION (20.205)

(obligations in thousands of dollars)

State or Territory	FY 2003 Actual	Estimated FY 2004 obligations from: Previous authority	New authority	Total	FY 2005 (estimated)	FY 2005 Percentage of distributed total
Alabama	641,871	489,287	129,075	618,362	627,256	1.96
Alaska	340,597	174,209	175,517	349,726	368,022	1.15
Arizona	490,487	418,247	143,928	562,175	542,788	1.70
Arkansas	412,238	348,694	49,416	398,110	409,257	1.28
California	2,241,105	2,642,020	317,709	2,959,729	2,990,695	9.34
Colorado	391,015	271,760	144,722	416,482	411,079	1.28
Connecticut	414,824	310,807	145,418	456,225	471,589	1.47
Delaware	129,317	108,380	34,748	143,128	138,203	0.43
District of Columbia	124,268	148,174	−19,571	128,604	123,616	0.39
Florida	1,253,242	1,020,565	522,523	1,543,088	1,528,053	4.77
Georgia	864,109	1,064,163	59,662	1,123,825	1,122,877	3.51
Hawaii	151,712	253,589	−90,654	162,935	161,134	0.50
Idaho	224,057	196,153	32,477	228,629	239,884	0.75
Illinois	941,354	950,184	103,789	1,053,972	1,056,801	3.30
Indiana	674,219	513,310	201,278	714,588	732,185	2.29
Iowa	384,612	304,256	74,764	379,019	373,096	1.17
Kansas	322,069	350,943	17,843	368,787	363,730	1.14
Kentucky	686,105	363,308	183,482	546,790	550,652	1.72
Louisiana	489,036	593,974	−108,562	485,412	504,786	1.58
Maine	156,372	117,916	50,039	167,955	164,204	0.51
Maryland	528,973	472,151	54,490	526,641	519,795	1.62
Massachusetts	528,665	1,084,896	−496,259	588,637	582,561	1.82
Michigan	843,702	750,560	228,138	978,698	981,577	3.07
Minnesota	418,333	434,907	17,666	452,572	467,011	1.46
Mississippi	368,746	320,575	57,858	378,433	384,908	1.20
Missouri	670,727	499,567	219,211	718,778	732,677	2.29
Montana	273,726	220,848	85,547	306,395	308,204	0.96
Nebraska	246,255	181,268	74,412	255,680	242,047	0.76
Nevada	220,862	187,342	44,012	231,354	226,414	0.71
New Hampshire	146,864	145,099	13,113	158,212	160,966	0.50
New Jersey	697,438	805,973	38,134	844,107	845,007	2.64
New Mexico	277,840	217,448	84,137	301,585	306,963	0.96
New York	1,443,380	1,479,163	91,698	1,570,861	1,611,749	5.03
North Carolina	806,493	581,186	309,845	891,031	889,435	2.78
North Dakota	181,711	166,091	43,001	209,092	204,899	0.64
Ohio	1,025,641	1,083,621	−20,681	1,062,940	1,084,841	3.39
Oklahoma	463,933	417,087	79,244	496,331	482,108	1.51
Oregon	398,445	259,465	107,393	366,859	379,112	1.18
Pennsylvania	1,398,201	1,494,436	−11,680	1,482,756	1,546,792	4.83
Rhode Island	186,391	139,618	51,107	190,725	185,258	0.58
South Carolina	470,886	393,183	132,586	525,769	522,758	1.63
South Dakota	205,689	210,595	9,001	219,596	222,860	0.70
Tennessee	593,275	690,403	−10,426	679,978	703,157	2.20
Texas	2,325,140	1,751,471	789,289	2,540,760	2,494,641	7.79
Utah	241,566	225,415	20,568	245,983	244,466	0.76
Vermont	120,979	146,156	506	146,662	142,786	0.45
Virginia	1,006,705	681,848	109,903	791,751	799,791	2.50
Washington	548,157	482,634	74,847	557,480	557,676	1.74
West Virginia	375,874	358,004	−45,406	312,598	349,817	1.09
Wisconsin	604,459	483,637	135,959	619,596	618,589	1.93
Wyoming	200,695	148,004	68,460	216,464	217,324	0.68
American Samoa	6,398	2,562	−2,562	....	122,587	0.38
Guam	20,028	....	....	....	....	....
Northern Mariana Islands	3,616	....	....	....	....	....
Puerto Rico	45,568	5,048	−5,048	....	....	....
Freely Associated States	....	....	....	....	....	....
Virgin Islands	12,581	22,414	−22,414	....	....	....
Indian Tribes	....	....	....	....	....	....
Undistributed	2,534,583	1,536,003	2,606,463	4,142,466	3,073,678	....
Total	**31,775,136**	**28,718,614**	**7,099,715**	**35,818,329**	**35,092,362**	[1] **100.00**

[1] Excludes undistributed obligations.

Table 8–30. FEDERAL TRANSIT CAPITAL INVESTMENT GRANTS (FIXED GUIDEWAY MODERNIZATION) (20.500)

(obligations in thousands of dollars)

State or Territory	FY 2003 Actual	Estimated FY 2004 obligations from:			FY 2005 (estimated)	FY 2005 Percentage of distributed total
		Previous authority	New authority	Total		
Alabama	....	....	....	....	....	....
Alaska	5,158	1,125	1,524	2,649	3,272	0.20
Arizona	....	2,069	1,719	3,788	3,632	0.22
Arkansas	....	....	....	....	....	....
California	125,302	32,629	108,338	140,967	202,839	12.41
Colorado	2,182	....	2,274	2,274	4,135	0.25
Connecticut	41,850	3,039	30,398	33,438	54,460	3.33
Delaware	3,500	....	....	....	....	....
District of Columbia	64,650	2,777	36,598	39,375	73,830	4.52
Florida	18,787	*	13,265	13,265	26,854	1.64
Georgia	42,954	....	19,971	19,971	35,091	2.15
Hawaii	3,052	597	836	1,433	1,622	0.10
Idaho	....	....	....	....	....	....
Illinois	138,542	*	99,746	99,746	177,587	10.87
Indiana	10,071	....	6,445	6,445	12,176	0.75
Iowa	....	....	....	....	....	....
Kansas	....	....	....	....	....	....
Kentucky	....	....	....	....	....	....
Louisiana	3,011	1,463	2,125	3,588	3,989	0.24
Maine	....	....	....	....	....	....
Maryland	18,665	17,837	20,801	38,638	39,334	2.41
Massachusetts	46,584	14,197	55,340	69,537	101,379	6.20
Michigan	916	323	442	765	925	0.06
Minnesota	7,307	21	4,480	4,501	8,745	0.54
Mississippi	....	....	....	....	....	....
Missouri	4,741	....	3,155	3,155	6,334	0.39
Montana	....	....	....	....	....	....
Nebraska	....	....	....	....	....	....
Nevada	....	....	....	....	....	....
New Hampshire	....	....	....	....	....	....
New Jersey	95,132	6,759	77,039	83,799	140,925	8.62
New Mexico	....	....	....	....	....	....
New York	388,567	*	272,954	272,954	499,120	30.54
North Carolina	....	....	....	....	....	....
North Dakota	....	....	....	....	....	....
Ohio	19,800	7,372	13,199	20,571	23,142	1.42
Oklahoma	....	....	....	....	....	....
Oregon	4,633	*	3,125	3,125	6,285	0.38
Pennsylvania	122,898	2,016	75,200	77,216	134,565	8.23
Rhode Island	....	1,675	60	1,735	126	0.01
South Carolina	....	....	....	....	....	....
South Dakota	....	....	....	....	....	....
Tennessee	313	26	213	239	454	0.03
Texas	6,822	6,174	7,461	13,635	11,811	0.72
Utah	....	....	....	....	....	....
Vermont	....	....	....	....	....	....
Virginia	7,518	1,284	12,061	13,345	24,000	1.47
Washington	19,161	2,425	16,535	18,960	33,137	2.03
West Virginia	....	....	....	....	....	....
Wisconsin	840	....	557	557	1,141	0.07
Wyoming	....	....	....	....	....	....
American Samoa	....	....	....	....	....	....
Guam	....	....	....	....	....	....
Northern Mariana Islands	....	....	....	....	....	....
Puerto Rico	1,443	3,288	1,684	4,972	3,401	0.21
Freely Associated States	....	....	....	....	....	....
Virgin Islands	....	....	....	....	....	....
Indian Tribes	....	....	....	....	....	....
Undistributed	7,363	1,082	11,994	13,076	12,387	....
Total	**1,211,764**	**108,178**	**899,541**	**1,007,719**	**1,646,701**	[1] **100.00**

* $500 or less or 0.005 percent or less.

[1] Excludes undistributed obligations.

Table 8–31. FEDERAL TRANSIT URBANIZED AREA—FORMULA GRANTS (SECTION 5307) (20.507)

(obligations in thousands of dollars)

State or Territory	FY 2003 Actual	Estimated FY 2004 obligations from:			FY 2005 (estimated)	FY 2005 Percentage of distributed total
		Previous authority	New authority	Total		
Alabama	19,868	5,924	11,389	17,313	7,046	0.44
Alaska	15,888	1,810	6,365	[1] 8,175	3,997	0.25
Arizona	987	51,975	33,396	85,371	21,151	1.32
Arkansas	10,928	1,379	5,913	7,291	3,805	0.24
California	855,823	167,606	440,486	608,092	272,991	17.08
Colorado	58,576	2,199	35,353	37,553	21,209	1.33
Connecticut	72,221	3,204	33,764	36,968	19,976	1.25
Delaware	10,872	2,383	4,622	7,005	2,990	0.19
District of Columbia	105,068	5,847	51,878	57,726	31,952	2.00
Florida	183,112	15,340	124,388	139,728	76,404	4.78
Georgia	108,398	40,587	50,531	91,118	29,145	1.82
Hawaii	25,404	756	19,844	20,599	13,002	0.81
Idaho	5,917	773	4,266	5,039	2,667	0.17
Illinois	269,824	4,805	164,655	169,459	101,628	6.36
Indiana	41,407	6,613	26,306	32,920	16,552	1.04
Iowa	14,246	1,597	9,567	11,164	5,907	0.37
Kansas	5,091	2,492	7,420	9,912	4,630	0.29
Kentucky	12,896	2,302	13,940	16,242	8,913	0.56
Louisiana	32,817	7,553	22,069	29,622	14,251	0.89
Maine	6,434	2,549	2,291	4,840	1,425	0.09
Maryland	66,263	969	51,943	52,912	32,132	2.01
Massachusetts	95,482	42,835	94,058	136,893	58,178	3.64
Michigan	92,722	4,146	50,293	54,439	31,466	1.97
Minnesota	58,164	16,153	32,035	48,189	19,466	1.22
Mississippi	7,296	1,502	3,794	5,296	2,465	0.15
Missouri	62,826	3,286	28,287	31,573	16,926	1.06
Montana	2,448	478	1,932	2,410	1,202	0.08
Nebraska	5,004	4,477	6,222	10,699	3,835	0.24
Nevada	33,326	15,212	17,988	33,200	11,391	0.71
New Hampshire	4,613	2,041	3,474	5,515	2,161	0.14
New Jersey	215,453	19,556	161,449	181,006	101,074	6.32
New Mexico	2,062	4,728	6,791	11,519	4,446	0.28
New York	626,112	51,459	409,483	460,942	256,437	16.05
North Carolina	39,524	20,092	27,852	47,945	17,642	1.10
North Dakota	3,003	120	2,286	2,407	1,422	0.09
Ohio	90,968	23,391	65,088	88,478	41,957	2.63
Oklahoma	13,110	1,668	10,805	12,472	6,642	0.42
Oregon	43,610	4,141	27,256	31,397	16,512	1.03
Pennsylvania	175,308	14,405	112,615	127,020	71,224	4.46
Rhode Island	20,097	317	6,853	7,170	4,137	0.26
South Carolina	14,364	8,174	10,520	18,694	6,634	0.42
South Dakota	2,096	423	1,757	2,179	1,093	0.07
Tennessee	31,033	3,258	21,219	24,477	13,470	0.84
Texas	281,815	36,144	146,865	183,010	91,483	5.72
Utah	29,728	777	21,506	22,284	12,690	0.79
Vermont	4,358	797	781	1,578	486	0.03
Virginia	64,743	21,088	40,078	61,167	25,414	1.59
Washington	95,659	34,747	70,792	105,539	44,574	2.79
West Virginia	5,219	628	3,704	4,332	2,304	0.14
Wisconsin	46,628	16,033	29,288	45,321	18,689	1.17
Wyoming	1,231	353	1,034	1,387	643	0.04
American Samoa	....	....	....	....	....	....
Guam	....	....	....	....	....	....
Northern Mariana Islands	....	....	506	506	315	0.02
Puerto Rico	76,261	60,681	32,208	92,889	20,024	1.25
Freely Associated States	....	....	....	....	....	....
Virgin Islands	....	....	....	....	....	....
Indian Tribes	....	....	....	....	....	....
Undistributed	17,602	....	....	[2]	[2]	....
Total	[3] **4,183,904**	**741,772**	**2,569,207**	**3,310,979**	**1,598,174**	[4] **100.00**

[1] Includes Alaska Railroad.

[2] Does not Include Oversight Section 5327.

[3] Includes Federal Highway Transfers.

[4] Excludes undistributed obligations.

Table 8–32. FEDERAL TRANSIT FORMULA AND RESEARCH GRANTS (SECTION 5307) (20.507)

(obligations in thousands of dollars)

State or Territory	FY 2003 Actual	Estimated FY 2004 obligations from:			FY 2005 (estimated)	FY 2005 Percentage of distributed total
		Previous authority	New authority	Total		
Alabama	....	....	....	....	11,399	0.44
Alaska	....	....	....	....	6,466	0.25
Arizona	....	....	....	....	34,216	1.32
Arkansas	....	....	....	....	6,155	0.24
California	....	....	....	....	441,615	17.08
Colorado	....	....	....	....	34,310	1.33
Connecticut	....	....	....	....	32,315	1.25
Delaware	....	....	....	....	4,837	0.19
District of Columbia	....	....	....	....	51,688	2.00
Florida	....	....	....	....	123,598	4.78
Georgia	....	....	....	....	47,148	1.82
Hawaii	....	....	....	....	21,034	0.81
Idaho	....	....	....	....	4,314	0.17
Illinois	....	....	....	....	164,403	6.36
Indiana	....	....	....	....	26,776	1.04
Iowa	....	....	....	....	9,556	0.37
Kansas	....	....	....	....	7,490	0.29
Kentucky	....	....	....	....	14,418	0.56
Louisiana	....	....	....	....	23,053	0.89
Maine	....	....	....	....	2,306	0.09
Maryland	....	....	....	....	51,980	2.01
Massachusetts	....	....	....	....	94,114	3.64
Michigan	....	....	....	....	50,903	1.97
Minnesota	....	....	....	....	31,489	1.22
Mississippi	....	....	....	....	3,988	0.15
Missouri	....	....	....	....	27,382	1.06
Montana	....	....	....	....	1,944	0.08
Nebraska	....	....	....	....	6,204	0.24
Nevada	....	....	....	....	18,428	0.71
New Hampshire	....	....	....	....	3,495	0.14
New Jersey	....	....	....	....	163,506	6.32
New Mexico	....	....	....	....	7,192	0.28
New York	....	....	....	....	414,835	16.05
North Carolina	....	....	....	....	28,539	1.10
North Dakota	....	....	....	....	2,301	0.09
Ohio	....	....	....	....	67,874	2.63
Oklahoma	....	....	....	....	10,745	0.42
Oregon	....	....	....	....	26,712	1.03
Pennsylvania	....	....	....	....	115,218	4.46
Rhode Island	....	....	....	....	6,692	0.26
South Carolina	....	....	....	....	10,732	0.42
South Dakota	....	....	....	....	1,768	0.07
Tennessee	....	....	....	....	21,791	0.84
Texas	....	....	....	....	147,992	5.72
Utah	....	....	....	....	20,528	0.79
Vermont	....	....	....	....	786	0.03
Virginia	....	....	....	....	41,111	1.59
Washington	....	....	....	....	72,107	2.79
West Virginia	....	....	....	....	3,727	0.14
Wisconsin	....	....	....	....	30,232	1.17
Wyoming	....	....	....	....	1,040	0.04
American Samoa	....	....	....	....	....	....
Guam	....	....	....	....	....	....
Northern Mariana Islands	....	....	....	....	509	0.02
Puerto Rico	....	....	....	....	32,392	1.25
Freely Associated States	....	....	....	....	....	....
Virgin Islands	....	....	....	....	....	....
Indian Tribes	....	....	....	....	....	....
Undistributed	....	....	....	....	....	....
Total	....	....	....	....	[1] **2,585,351**	**100.00**

[1] In the President's FY 2005 Budget, the Administration is proposing the creation of this new account.

9. INTEGRATING SERVICES WITH INFORMATION TECHNOLOGY

This year the President is proposing to spend nearly $60 billion for computers, software, and services used to deliver benefits and services to American citizens. It is a priority for agencies to focus this investment on the achievement of goals that will result in benefits to the American people.

There are three major efforts underway to assure the Federal Government's investment in Information Technology brings the greatest value to the public:

- Management for Results
- Successful Uses of Electronic Government
- Modernization Blueprints

MANAGEMENT FOR RESULTS

The Clinger-Cohen Act of 1996 calls for Federal departments and agencies to find ways to use technology to accomplish their mission; to operate more proficiently; and to make better purchasing decisions. The Act requires the Director of the Office of Management and Budget (OMB) to submit a report to the Congress on the results we're achieving from Federal IT spending. This Budget chapter fulfills the statutory reporting requirements of the Clinger-Cohen Act through Chapter 9, Table 9–1, Effectiveness of Agency's IT Management and E-Gov Processes, included on the CD–ROM, which summarizes the results of IT management processes at major agencies.

As a result of the Administration's oversight, agencies' capital planning activities have improved. Agencies are now better able to identify "net program performance benefits achieved" by their IT investments and "how the benefits relate to the accomplishments of the goals" of their agency. However, much work remains to move beyond good explanations to good—and measurable—results.

Performance of Government.—Agencies need proper management practices and support systems to deliver projects on time, within budget, and performing as expected. Once the IT projects represented by these investments move from planning to operations, agencies must be able to determine whether or not the projects continue to accomplish the intended outcome while staying within the approved budget.

These projects must have:

- Sound risk management strategies; and
- Strong links to agency mission and strategic goals.

While ensuring the projects are:

- On schedule and within the approved budget;
- Achieving performance goals; and
- Included in the modernization blueprint for the agency, called an enterprise architecture

The Government continues to improve productivity and demonstrate results from its IT investments. The Administration requires all cabinet agencies to prepare "business cases" for any planned or operational system that is critical to the mission of the agency. These investment rationales are graded on specific criteria including:

- the value they will provide to the agency
- the likelihood they will succeed
- the cyber-security plans planned or in place
- the acquisition strategy
- the project management plans
- the analysis of viable alternatives

Government agencies continue to make significant improvement in their efforts to guarantee the prudent expenditure of taxpayer dollars. All of the 59 business cases submitted by the Department of Veterans Affairs passed the scoring criteria without revision of the original business cases. To achieve this, VA developed a project management agenda and trained more than 500 project managers while instituting a rigorous internal review process to pre-score their business cases before submission to OMB.

The Administration continues to monitor the performance of its IT projects long after the original budget request is made. For example, of the $60 billion in the 2005 Budget for IT investments, 621 major projects representing $22 billion are currently on the "Management Watch List." This list includes mission-critical projects needing improvement in the areas of performance measures, earned value management and/or IT security. Agencies must remediate the shortfalls identified in their business cases or the Administration will not support the expenditures until agencies have demonstrated their ability to address these weaknesses.

The Agency IT Investment Portfolios (available in Exhibit 53 on the Internet at *www.whitehouse.gov/OMB)* provide details of the Administration's proposed 2005 IT investments. Related documents on IT security and Electronic Government (E-Government) will also be available at *www.whitehouse.gov/OMB* and will be published by March 1, 2004.

As part of the process by which the Administration evaluates IT business cases, investments are studied to determine whether there is duplication across Government entities. If an investment is found to be duplicative, the Administration brings together the appropriate agencies and helps them consider broad based solutions that will allow inter-agency data sharing and cooperation to build a single system, rather than maintaining separate investments.

This Administration leverages Government buying power while reducing redundant purchases. As an example, the Government is developing common solutions that meet multiple agencies' needs in the areas of Financial Management and Human Resources.

As part of its management responsibilities, OMB continued using one of the key authorities established in section 5113 "Enforcement of Accountability" of the Clinger-Cohen Act (CCA). Under this authority, the Director is required to evaluate information resources management practices of the executive agencies with respect to IT investments. As part of this evaluation, OMB issued one Clinger-Cohen letter, M–03–14 "Reducing Cost & Improving Quality in Federal Purchases of Commercial Software" (06/02/2003). The purpose of this letter was to coordinate and leverage the buying power of Government by creating the Software Managed and Acquired on the Right Terms (SmartBUY) initiative. This letter is available at *www.whitehouse.gov/omb/memoranda/m03–14.html*. In addition, management guidance titled "Streamlining Authentication and Identity Management" was issued on July 3, 2003. This memorandum provides agency Chief Information Officers (CIOs) with the appropriate guidance to coordinate and consolidate investments related to authentication and identity management and is available at *www.whitehouse.gov/omb/inforeg/eauth.pdf.*

The Government IT Workforce.—As part of the President's Management Agenda (PMA), analysis is underway to develop a strategy for the recruitment, development, retention, and management of the Federal IT workforce and to insure that expenditures in technology are professionally delivered and managed. The immediate focus is to assess the current "bench strength" among existing employees, identify gaps in needed skills, and develop plans of action to fill critical workforce needs for project managers, solution architects, security specialists, and other need areas as identified in the Federal workforce survey completed in the fall of 2003 by the Office of Personnel Management (OPM) and the Federal CIO Council.

Electronic Government..—Expanding Electronic Government makes it easier for citizens and businesses to interact with their Government and saves taxpayer dollars by reducing the cost of delivering those services. The Administration developed specific E-Government projects and an overall agenda of bringing the principles of E-Government to all Government programs, allowing taxpayers to conduct business with Government in their own time and on their own terms.

For the past five years the Government has been aggressively implementing the Government Paperwork Elimination Act. The Act required the Government to provide the option for electronic filing and electronic signature for the full range of Government activities unless it is not practicable to do so. During the first two years of the Act's implementation, 1,800 transactions could be conducted electronically. As of December 2003, 4,000 government transactions could be conducted electronically. This represents 57% of the 7,000 potential transactions between citizens and their government. For instance:

- The Department of Agriculture is implementing an agency-wide system to conduct business electronically; and
- The Department of Transportation established an efficient online method for motor carriers to apply for operating authority and register for a USDOT number.

As the Government continues to use new technology our business processes continue to improve. One specific example is the way we keep records. The National Archives and Records Administration (NARA) will preserve our electronic records for future generations just as it has for paper records in the past. NARA's Electronic Records Archives project will preserve and provide access to digital records from Federal agencies. NARA's work on the Electronic Records Management initiative will provide agencies with the policies and procedures necessary for managing these electronic records. Because of this foresight, historians will be assured of continuing access to essential evidence documenting the rights of American citizens, the actions of Federal officials, and the national experience.

Securing Government Systems..—Over the last three years the Federal Government has improved considerably in identifying and resolving long-standing, serious, and pervasive IT security problems. Agencies report both annually and quarterly on their efforts to address IT security weaknesses against key IT security performance measures.

As one example, the *Environmental Protection Agency* has excelled at protecting their information technology assets. EPA has evaluated the risks to, and certified the security of, its IT systems. Beyond documentation, however, EPA has implemented quantifiable measures of repelled attacks and blocked viruses. Internal scorecards are used to measure success and managers are encouraged to compete for top scores. By focusing on cyber-security, EPA has taken great steps to protect the integrity of the agency.

In addition to assessing each agency's IT security performance, the Administration also established the following three Government-wide goals in the 2004 President's Budget.

- Goal 1.—By the end of calendar year 2003, all Federal agencies were to have created a central remediation process to ensure that program and system level IT security weaknesses, once identified, are tracked and corrected. Each agency Inspector General (IG) was to verify whether or not the agency had a satisfactory IT security remediation process in place.

  Status.—While each Federal agency does have an IT security remediation process, the maturity of those processes vary greatly. Out of 26 Federal agencies, 10 agencies have a remediation process verified by their IG as meeting the necessary criteria. The Administration will continue to work with the remaining Federal agencies to achieve this goal by the end of calendar year 2004.

- Goal 2.—By the end of calendar year 2003, 80 percent of Federal IT systems were to be certified and accredited.
  Status.—Based on agencies' reports 61 percent of Federal IT systems were certified and accredited at the end of calendar year 2003. At the end of calendar year 2002, only 47 percent had met this goal. Many agencies are not adequately prioritizing their IT expenditures to be assured that significant IT security weaknesses are appropriately addressed.
- Goal 3.—By the end of calendar year 2003, 80 percent of the Federal Government's 2004 major IT systems were to have appropriately integrated security into the lifecycle of the expenditures.
  Status.—Based on agencies' reports for 2003, 75 percent of Federal IT systems planned and budgeted for IT security requirements as part of the overall development or maintenance. At the end of calendar year 2002, this number was slightly more than 60 percent. While agencies have made improvements in integrating security into new IT systems, significant problems remain, particularly in ensuring security of legacy systems.

Additionally, the Federal Government has placed increased emphasis on prevention of negative impacts from worms and viruses through the installation of patches for known vulnerabilities. Further, improved information sharing allows agencies to rapidly identify and respond to cyber threats and critical vulnerabilities. These steps have led to stronger Government-wide processes for intrusion detection and response.

While notable progress in resolving IT security weaknesses has been made, challenges remain and new threats and vulnerabilities continue to materialize. Agencies continue to improve the security of the information and systems supporting the Federal Government's missions. To address the above challenges the Administration works with agencies, Inspectors General, the Congress and the General Accounting Office (GAO) to assure appropriate cost-effective IT security programs, policies, and procedures are in place to protect Government systems.

Additional information and detail concerning the Federal Government's IT security program and agency IT security performance can be found in *OMB's Annual Report to Congress on IT Security*. The next such report will be issued by March 1, 2004 and will be made available on OMB's website.

Protecting Privacy.—The promise of E-Government can only be realized if people use the services provided by the Government. Citizens will only use these services if they trust their information will be protected and their privacy maintained. The obligation to maintain the public's trust is demonstrated by the passage of the E-Government Act, which reflects the Government's commitment to the privacy and security of the citizen's confidential information. Specifically, the E-Government Act requires agencies, as they develop new information technology systems or information collections, to:

- Conduct Privacy Impact Assessments (PIAs) taking privacy into consideration in the design of the system or in any information collection activities.
- Publicly post standardized web privacy policies regarding the handling of personal information provided electronically to the Government.

The greater challenge for Government is clearly the PIAs. These assessments demand the combined analysis of individuals with technical, programmatic and legal expertise. With varying degrees of success, agencies attempted to comply with the new statutory mandate. Going forward, the Government must continue to meet the challenges presented by privacy concerns and ensure PIAs include consideration of alternative business processes or systems designs. The Administration anticipates greater transparency on the part of Government agencies as the PIA effort continues. This will inspire greater trust in and greater use of E-Government products.

Making Government Accessible to All.—The Government is making its websites and information technology accessible to persons with disabilities by providing new standards for accessibility, developed in accordance with Section 508 of the Rehabilitation Act of 1973. These new standards assume access to Government information and data is a civil right. The Government is engaged in a variety of activities to fulfill the requirements that agencies, industry, and the public understand these standards. This year, the Administration conducted extensive outreach with industry, the public, and Federal agencies to assist in implementation. Additionally, the *General Services Administration* (GSA) developed a web-based tool to help agencies procure information technology accessible to persons with disabilities. In the next year, GSA will issue a survey to assess how Federal agencies are implementing the Section 508 accessibility standards and to allow agencies to share best practices.

SUCCESSFUL USES OF ELECTRONIC GOVERNMENT

E-Government seeks to leverage information technologies to make Government services available to the citizen while guaranteeing the security of those systems, the privacy of citizen information and the prudent use of taxpayer money. E-Government is about helping the citizens, businesses and Government conduct business with one another more efficiently and effectively.

Previously, the agency was the focus of the process because the citizens had to adjust their schedule and circumstances in order to accommodate the transaction with the Government. Now, the citizen and the assistance they require are the focus of the process. The service is more important than the bureaucracy.

For Governments and agencies, the benefit comes in the form of improved business processes, the way and the speed with which business is conducted. By collecting the data electronically, agencies benefit by reducing the processing time for transactions. This allows agencies to share data more easily, and speeds transactions conducted between and within agencies.

Examples of successful adoption of the tenets of E-Government to deliver services to the citizen and make the government more effective include the *National Science Foundation* (NSF) and the *Office of Personnel Management*. NSF's FastLane system is used by more than 200,000 scientists, educators, technology experts and administrators to conduct business over the Internet. OPM manages five Presidential E-Government initiatives including USAJOBS, which receives on average 200,000 visits per day by Federal employment job seekers who can create resumes using the tools available on-line. Federal employees have taken more than 160,000 courses through the Gov Online Learning Center (GoLearn.gov), while E-Payroll is consolidating agencies payroll services into four service providers

Government agencies have traditionally considered themselves as separate businesses with each serving its own mission. Citizens, however, may not draw distinctions between different agencies and agency missions; they simply want access to information in a timely fashion. Through the PMA, the Presidential E-Government initiatives and the efforts to provide a Federal Enterprise Architecture (FEA), Government is managing itself as one business with many subsidiaries. Through multi-agency E-Government initiatives such as Regulations.gov and Grants.gov, multiple agencies work together to provide service to the citizen from a single location.

Regulations.gov makes it easier for citizens and businesses to easily find, review, and submit comments on proposed rules in the Federal Register that may affect them.

Grants.gov makes it easier for grant seekers to find and apply for more than $350 billion in Federal grant opportunities across more than 900 programs in 26 agencies. Equally important, grant-seekers won't have to visit each federal agency's website every day to find or apply for grant opportunities.

Chapter 9, Table 9–2, Status of the Presidential E-Government Initiatives, included on the CD–ROM, provides an update for each project.

MODERNIZATION BLUEPRINTS

Over the past three years, as a result of the implementation of this Administration's Electronic Government initiative, dramatic changes have begun to occur in the way the Government uses information technology to provide services to citizens. Federal agencies are rapidly developing and implementing sophisticated IT management policies and practices for their Capital Planning and Investment Control, professional project management practices and processes, and comprehensive security management practices

Computers and related IT equipment and services are a means to an end, not an end in and of themselves. They are a tool to do a job and must support the business of the agency in order to be effective. IT, properly managed and focused, can help deliver government services and results to the public faster, cheaper, and with better quality than current methods. To gain the maximum benefit from IT systems, Agencies must understand how technology fits into and can support their missions.

The FEA and the companion efforts of the agencies' Enterprise Architectures together provide the "blueprint" for completing analysis in the areas of common business practices, opportunities for consolidation, and acceleration of service delivery. OMB, in collaboration with the Federal CIO Council, is developing the Government-wide FEA to provide a common view across the Government of the work agencies do and the technology used to deliver services. The FEA creates the blueprint to identify where agencies share common functions and consequently can use shared technology solutions. With these efforts, the Government is completing the design of a common, shared information technology support structure within and across agencies.

Historically, data communications, databases, office automation and security have been planned and deployed to support individual agencies, or even individual organizations and applications within an agency. This process has led not only to duplication but also to difficulty in operating effectively across lines of business. To address these deficiencies, the Administration asked agencies to plan for the integration of their common infrastructure and office automation environments. Included in these plans were strategies to move towards an integrated support environment while using the Government blueprint. The final result of these plans, migration strategies and support systems will be a comprehensive Government-wide view of the technologies being used to support the implementation of agency and cross-agency systems.

To support the implementation of the agencies' modernization efforts, the Administration initiated programs like SmartBUY. This initiative leverages the immense buying power of the Federal Government in order to achieve the maximum cost savings, most favorable terms and conditions, and the best quality commercial brand-name software while continuing to motivate vendors to do business with the Government.

Sharing Technology across Agencies Will Drive Results.—While the effort to integrate and consolidate IT environments within an agency can provide substantial cost savings and performance improvement, the real potential benefit comes from the integration of agency processes and systems and the extension and integration of those environments across agencies. Based on the initial implementation of the FEA in the 2004 budget, six common areas where the work activities of diverse agencies were similar or nearly identical in providing services to citizens were identified. These strong similarities in activities present excellent opportunities for sharing resources and gaining efficiencies. The results of on-going analysis will provide the opportunity for breakthrough improvements in service performance for citizens.

For example, the Health and Case Management functions have become the subject of Government-wide collaboration initiatives. The Department of Health and Human Services has taken the lead in a broad cross-agency effort to develop a complete architecture for the Health function, which is expected to yield a number of major cross-agency initiatives. The Department of Justice has taken a leading role in developing a broader cross-agency approach to Case Management that will enable agencies to implement common business practices and technology solutions to this widely used process.

Initiatives such as these will result in "best practice" solutions that span across agencies, and across all levels of government to bring significant benefits to citizens, businesses, and government entities.

Other areas of commonality that have already been identified for similar initiatives include Financial Management, Human Resources Management, and Grants. These common functional areas will be targeted by cross-agency teams for integration and consolidation. These efforts are expected to yield new common practices and technology initiatives to save money, improve efficiency and provide for significant improvements in service delivery beginning in 2005.

Moving Forward.—In 2005 and beyond, the Government will continue identifying additional areas where the work of agencies is similar enough to believe that a shared approach to the use of information technology will yield major benefits. This effort will pave the way for major breakthroughs in the pace at which agencies can adapt to changing mission needs and deliver the results citizens are demanding.

The Federal Government has made significant progress in implementing E-Government to better serve the citizen, but much remains to be done. Through the PMA, the Clinger-Cohen Act, the E-Government Act, and budget guidance, the Federal Government has the tools necessary to make it easier for citizens and businesses to interact with their Government. Through sound management practices, responsible investment, improved security and privacy, and innovative approaches to meeting the needs of the taxpayer, agencies can accomplish this important goal.

10. FEDERAL DRUG CONTROL FUNDING

Table 10–1. FEDERAL DRUG CONTROL FUNDING, FY 2003–2005[1]

(Budget authority, in millions of dollars)

Department/Agency	FY 2003 Enacted	FY 2004 Estimate	FY 2005 Request
Department of Defense	906	909	853
Department of Education	644	624	611
Dept. of Health and Human Services	3,315	3,480	3,657
National Institutes of Health	961	991	1,019
Substance Abuse and Mental Health Services Admin	2,354	2,489	2,638
Department of Homeland Security	2,040	2,383	2,519
Immigration and Customs Enforcement	518	539	576
Customs and Border Protection	874	1,070	1,121
U.S. Coast Guard	648	774	822
Department of Justice	2,430	2,483	2,750
Bureau of Prisons	43	48	49
Drug Enforcement Administration	1,640	1,703	1,816
Interagency Crime and Drug Enforcement[2]	477	551	581
Office of Justice Programs	270	181	304
ONDCP	521	522	511
Operations	26	28	28
High Intensity Drug Trafficking Area Program	226	225	208
Counterdrug Technology Assessment Center	47	42	40
Other Federal Drug Control Programs	222	228	235
Department of State	874	914	922
International Narcotics Control and Law Enforcement Affairs	145	188	191
Andean Counterdrug Initiative	729	727	731
Department of Veterans Affairs	664	765	823
Other Presidential Initiatives[3]	3	2	4
Total Federal Drug Spending	**11,397**	**12,082**	**12,649**

[1] Detail may not add due to rounding.

[2] Prior to FY 2004 funds for the Interagency Crime and Drug Enforcement programs were appropriated into two accounts, one in the Justice Department and one in the Treasury Department. Beginning in FY 2004, those accounts were consolidated. In this table, funding is shown as combined for all three years.

[3] Includes Small Business Administration Drug Free Workplace grants and National Highway Traffic Safety Administration Drug Impaired Driving Program.

ECONOMIC ASSUMPTIONS AND ANALYSES

11. ECONOMIC ASSUMPTIONS

Introduction

The economic outlook appears brighter now than at any time in recent years. Expansionary fiscal and monetary policies, combined with the inherent resilience of the American economy, have finally succeeded in overcoming the forces of restraint that have held growth back. Barring adverse shocks, over the near-term there is good reason to believe that a self-sustaining and on-going expansion is at hand, one that will create more jobs, more income, and more consumer spending and business investment.

From a longer-term perspective, the expansion should proceed briskly in the years ahead due to strengthened productivity growth and improvements in the tax system that will make it easier for markets to reward work and investment. A healthy economy will raise living standards and shrink the budget deficit when combined with restraint in Federal spending.

Economic growth began to slow in 2000 following the stock market downturn that began in March. The decline showed up first in manufacturing, where employment peaked in July 2000. The overall economy contracted in the third quarter of 2000, and the slowdown turned into a brief, mild recession in early 2001 that was over by the end of the year. Although the economy began to expand in the fourth quarter of 2001, the pace of growth was initially well shy of that of a normal recovery and the labor market weakened further. In a typical business recovery, employment begins to rise soon after the recession ends, but in this instance payroll employment sagged for many months following the recession trough.

Beginning in mid-2003, however, there were gathering signs of self-reinforcing economic growth. In such a virtuous circle, rising employment adds to workers' incomes and supports consumer spending, which leads to additional increases in output and further gains in employment. Growing consumer confidence contributes to new spending and is further strengthened by continued growth and prosperity. Meanwhile, as businesses experience increased sales, orders, and profits, they are encouraged to boost capital spending, which creates still more jobs and income. Improved business conditions strengthen investor confidence in the economy's future, which drives up the stock market, boosting household wealth and reducing the cost of capital to business, which helps spur further growth.

The process can continue as long as inflation and interest rates remain low and the economy does not bump up against supply constraints. With inflation and interest rates at their lowest levels in decades, there is good reason to expect that the strengthening economic forces now emerging will return the economy to high levels of labor and capital resource use.

Productivity growth accelerated in the last half of the 1990s and has stepped up still further in the last three years. Some of the recent acceleration is very likely a temporary gain: cyclical pressures pushed firms to cut labor and other costs in the face of weak sales. Even taking such cyclical factors into account, however, the underlying pace of productivity growth appears to have improved significantly. If more rapid productivity growth is sustained, then future economic growth would be considerably stronger than most forecasters currently expect. Consistent with conservative forecasting, the Administration assumes productivity growth that is slower than recent experience and close to the average pace of the last four decades.

The Administration's economic near- and medium-term projections reflect a reasonably sanguine view of the outlook, which is shared by most forecasters. The Administration's economic projections are similar to those of private sector forecasters and the Congressional Budget Office. However, after several years of generally disappointing economic news, it would not be surprising if the gathering positive cyclical forces propelled the economy forward even faster than is now generally anticipated.

Policy Actions

Fiscal Policy: During the first three years of this Administration, the President proposed and Congress passed three important tax relief measures that have helped pull the economy out of recession and provide a foundation for future growth.

- In June 2001, the President signed the Economic Growth and Tax Relief and Reconciliation Act (EGTRRA). It provided significant income tax rate reductions including lower marginal income tax rates; a reduction in the marriage tax penalty; and a new, lower, 10 percent tax bracket. Beginning in July 2001, 85 million taxpayers received rebate checks totaling $36 billion reflecting the new 10 percent bracket. The rebate and lower withholding rates bolstered consumer spending at a critical juncture, helping to return the economy to growth by the end of 2001.
- In March 2002, the President signed the Job Creation and Worker Assistance Act (JCWAA). The main provision of JCWAA reduced the tax disincentive for business to invest by permitting expensing on 30 percent of the value of qualified new capital assets, primarily equipment and software. This expensing provision created a temporary period of lower capital costs until the provision originally expired in September 2004. JCWAA

was aimed directly at weak capital spending, a key reason why the business cycle recovery was much slower than usual. The Act also provided additional unemployment benefits for long-term unemployed workers who exhausted their regular unemployment insurance benefits.

- In May 2003, the President signed another extension of unemployment insurance benefits for individuals who had exhausted their regular benefits. He also signed the Jobs and Growth Tax Relief Reconciliation Act (JGTRRA) to provide additional stimulus to the subpar recovery. This legislation:

  1) Advanced the date at which the 2001 tax bill's lower marginal individual income tax rates were to take effect and made them retroactive to January 2003; raised the child tax credit for 2003 and 2004, with the 2003 increase given to families in the form of rebate checks during the summer; advanced the reduction in the marriage penalty; and raised the exemption amount for the individual Alternative Minimum tax (AMT) in 2003 and 2004. (Taxpayers pay the higher of their tax liability as determined by the regular income tax and the AMT calculation.)

  2) Reduced the individual income tax rates on dividend income and capital gains. The tax bill reduced to 15 percent the maximum tax rate on dividends which previously were taxed at the taxpayer's marginal tax rate, and it reduced the maximum tax rate on net capital gains (the excess of net long-term gains over net short-term losses) from 20 percent to 15 percent. Tax rates on capital income were also reduced for those lower income families paying less than the maximum rate. The reductions in the tax rates on capital gains and dividends reduced a longstanding distortion in the tax code: the double taxation of corporate earnings that had lowered business investment and biased corporate financing against equity and in favor of debt.

  3) Raised the expensing provision of the 2002 tax bill from 30 percent to 50 percent and extended the window for eligible investments from September 11, 2004 to the end of the year. Also, the maximum amount of new investment that a small business can expense was raised from $25,000 to $100,000.

All told, the three tax relief bills provided $68 billion in tax stimulus in fiscal year 2001, $89 billion in 2002, $159 billion in 2003, $272 billion in 2004, and $171 billion in 2005. The total stimulus, including assistance to States and long-term unemployed workers, was even larger.

Tax relief played a crucial role in ending the 2001 recession and then invigorating the recovery. It took two years, but the stimulus in the tax bills is finally producing the rapid economic growth that the economy needs and that will eventually generate new jobs and higher incomes. In addition to the near-term stimulus, the 2001 and 2003 Acts also made fundamental improvements in the Nation's tax system that will raise the long-term level of economic activity by reducing the disincentives and distortions in the system.

- The reductions in marginal tax rates mean that individuals, sole proprietorships, and partnerships will have more incentive to produce more, earn more, save more, and invest more.
- Lower tax rates on dividends and capital gains will lower the after-tax cost of purchasing capital equipment and software, thus raising the rate of investment. Lower tax rates will also shift investment to more productive uses by reducing distortions in the pattern of investment caused by the tax system. By reducing the bias in favor of debt over equity finance, lower tax rates on dividends and capital gains will encourage corporations to maintain stronger balance sheets.
- The reduction in the individual capital gains tax rates will encourage more high-risk, high-payoff investments essential to maintaining a dynamic economy and ensuring U.S. competitiveness in the world economy.
- Lower tax rates on capital income will help raise asset values and thereby improve household and business balance sheets.

The short-term benefits of fiscal stimulus are already evident in the quick end to the recession in 2001 and the further surge in economic growth that occurred in the second half of 2003. The tax cuts have helped to transform an ailing economy into a healthier one. The longer-term benefits from an improved tax system will be evident in the years ahead as new incentives alter the behavior of individuals and businesses in ways that augment economic growth.

Monetary Policy: Since early 2001 the Federal Reserve has aggressively pursued a policy aimed at restoring strong, self-sustaining growth. As it became clear that the abrupt slowing of growth in late 2000 would likely turn into a recession in early 2001, the Federal Reserve cut the federal funds rate sharply. Eventually, it lowered this key interest rate eight times, bringing it down from 6½ percent at the start of 2001 to 3½ percent by August. In the months following the terrorist attacks of September 11th, the Federal Reserve cut the rate four more times bringing it to just 1¾ percent by the end of the year, the lowest level since the early 1960s.

As the economy began to expand beginning in the fourth quarter of 2001, the Federal Reserve held the federal funds rate constant, but as the pace of growth proved disappointing and payrolls continued to contract, the Federal Reserve reduced the funds rate to 1¼ percent in November 2002 and to 1 percent in June 2003. Even as growth accelerated in the second half of 2003, the Federal Reserve indicated that it intended to maintain an accommodative monetary policy for a considerable period of time.

At the longer end of the maturity spectrum, interest rates declined sharply in late 2000 as markets perceived the slowdown in the economy. They remained about unchanged during 2001, and then resumed their decline in 2002 and the first half of 2003. At its low point in June 2003, the yield on the 10-year Treasury note fell to 3.1 percent, three percentage points below its level three years earlier and the lowest level since the late 1950s. The yield rose during the second half of 2003 and finished the year at 4.3 percent. With the exception of the past year and a half, this is the lowest level for the 10-year note since 1965.

The decline in long-term interest rates that continued until mid-2003 reflected slack credit demand, a reduction in inflation and in inflation expectations, and the easing of monetary policy. The final phase of the decline in rates in May through June 2003 also reflected some apparent confusion in financial markets regarding the Federal Reserve's intentions. The rise in long-term rates during the second half of 2003 reflected a better understanding by market participants of Federal Reserve policy, along with the pickup in economic activity, and the expectation of further strengthening of the expansion in 2004.

The trend in yields on long-term private sector instruments was similar to that of Treasury notes, declining to very low levels by mid-2003 and then rising to still relatively low levels by year's end. The yield on corporate AAA bonds closed the year at 5.6 percent, the lowest level since 1967. The rate on 30-year fixed rate mortgages finished the year at 5.8 percent, the lowest level since the early 1960s.

Recent Developments

The economic expansion that began in late 2001 was restrained by a number of special factors. The stock market decline, which lasted from early 2000 until early 2003, was much longer—and much steeper—than in a typical business cycle. The market decline was prolonged by the corporate accounting scandals in 2002 that shook investor confidence. The erosion of consumer confidence was another negative factor that persisted until early 2003, well beyond the normal cyclical correction. Confidence was sapped not only by economic conditions in 2001–2002, but also by the terrorist attacks on September 11, 2001, and subsequent developments in the War on Terror which periodically heightened anxiety. Another factor holding back growth was the business capital stock overhang that had emerged in late 2000 and needed to be worked off. The overhang held down investment spending until mid-2003. Finally, slow growth, or even recession, in other leading industrial nations curtailed U.S. exports.

These obstacles to growth had been overcome or greatly reduced by mid-2003. The stock market was on the rise again as the uncertainties surrounding the 2002 accounting scandals subsided and new legislation passed in 2002 led to wide-ranging reforms of corporate governance. Consumers and investors became more optimistic as the Administration and the American people together successfully met the domestic and international threats to the Nation's security at home and overseas. Businesses had largely eliminated the excess capital stock by mid-2003, and investment began increasing again. Growth abroad also picked up modestly. The attenuation of these special factors permitted the highly stimulative fiscal and monetary policies put in place in 2001–2003 to operate to full effect, restoring the economy to a healthy growth rate.

The economy surged in the third quarter of 2003 as real GDP growth soared to an 8.2 percent annual rate, the fastest quarterly advance since 1983. Growth in the fourth quarter undoubtedly moderated from this stellar pace, but it appears to have remained robust. (The official estimate of fourth quarter growth was not available until after the Budget had gone to press.)

A telling indication that the expansion has become healthier and more self-sustaining is the more balanced mix of the growth of GDP components. Unlike the initial phase of the expansion, which was dominated by consumer and Government spending, growth is now being propelled by business and consumer spending as Government spending growth slows.

Components of Aggregate Demand: Business investment in equipment and software, adjusted for inflation, increased at an 18 percent annual rate in the third quarter, the fastest growth in 5½ years. Rising shipments of nondefense capital goods in October and November suggest that equipment investment made a substantial contribution to GDP growth in the fourth quarter as well. Business investment in structures has leveled off instead of declining as it had earlier. Given the usual lags, an upturn in spending on structures is increasingly likely this year.

The stalwart of the expansion has been consumer spending, and it continued to expand rapidly at nearly a 7 percent annual rate in the third quarter. Consumption probably remained strong in the fourth quarter, as well. Individuals' discretionary spending, such as for new cars, has been especially robust. Residential investment has been the other mainstay of the expansion so far, spurred by relatively low mortgage rates. Residential investment spending rose at over a 20 percent rate in the third quarter, the fastest pace in a decade. Housing starts in November reached the highest level in almost twenty years, which suggests another double-digit rise in residential investment in the fourth quarter.

Other Indications of Stronger Growth:

- The Nation's payrolls have begun increasing again, and unemployment is on the decline. The unemployment rate fell from 6.3 percent in June to 5.7 percent in December. From July to December, employers added 278,000 workers to their payrolls, reversing the trend of shrinking payrolls of the prior months. However, the gain in December of only 1,000 jobs suggests that job creation at the end of the year was still well shy of the usual expansion pace. Further significant payroll gains are likely in 2004, although recent experience suggests that job growth may remain uneven through the early part of the year.

- Output in the hard-hit manufacturing sector turned around in 2003. Manufacturing production during September through December rose at the fastest pace in nearly four years. The Purchasing Managers' Index, a forward looking indicator of manufacturing activity, reached 66 in December, the highest level in 20 years. A reading above 50 indicates an expanding manufacturing sector.
- Consumer and investor confidence has risen sharply. From their low points in March 2003, the University of Michigan Index of Consumer Sentiment increased nearly 20 percent through December and the Conference Board measure advanced almost 50 percent. A survey of investor confidence conducted by UBS/Gallup rose from a low reading of 5 in March to 104 in December.
- Corporate profit margins and overall profits expanded briskly in 2003, which should help foster further increases in business hiring and capital spending in 2004. In the third quarter, the share of profits in GDP reached 10 percent, the highest level since late 1997. Strong productivity growth, well in excess of the growth of labor compensation, has contributed to the growth of profits by lowering unit labor costs and raising profit margins.
- Stock markets have soared since March 2003. The S&P 500 and the Dow Jones Industrial average each gained about 30 percent during the last nine months of 2003; the NASDAQ, with its predominance of high-tech companies, rose 50 percent. The increase in equity values added almost $3 billion to household wealth from the end of March to the end of December and reduced the cost of equity capital to businesses.
- At the same time that economic activity has been picking up, inflation has been drifting lower. The core Consumer Price Index, which excludes the volatile food and energy components, increased a mere 1.1 percent in the 12 months ending in December 2003. That is the lowest rate in 40 years and well below the 2.7 percent increase at the recession's trough in November 2001. The rise in the overall CPI was 1.9 percent during the most recent 12 months. This was higher than the core rate mainly because of a jump in energy prices. The GDP price index increased 1.7 percent in the year ending in the third quarter of 2003. The absence of any significant inflationary pressures suggests that the Federal Reserve should be able to maintain an accommodative monetary policy for some time yet.

Productivity and the Longer Run Outlook: Since the fourth quarter of 2000, productivity in the nonfarm business sector has risen at a 4.4 percent annual rate. That is much faster than the 1.4 percent average from 1974 to 1995 and faster even than the accelerated 2.5 percent pace during the latter half of the 1990s. While some of the recent step up is likely attributable to intense cost cutting during the recession and the subsequent slow recovery, and therefore transitory, a considerable part of the productivity improvement is likely to prove to be permanent. Strong productivity growth is the best foundation for continued economic growth.

In summary, the accommodative stances of fiscal and monetary policy have combined to ignite a more vigorous expansion. Growth is likely to be above average this year, accompanied by further declines in unemployment and stronger employment gains. Beyond this year, solid productivity growth, low inflation, and an improved tax framework offer the prospect of a new, extended period of robust economic growth.

Economic Projections

The Administration's economic projections are summarized in Table 11–1. These assumptions are close to those of the Congressional Budget Office and the average of private sector forecasters, as described in more detail below. The assumptions were based on information available as of late November. In December, the Bureau of Economic Analysis released a comprehensive revision of the National Income and Product Accounts. The Addendum to Table 11–1 presents the assumptions on a basis comparable to the revised national accounts.

As the foregoing discussion suggests, the Administration is projecting the economy to improve steadily. The major contributors to economic growth this year are likely to be business investment and consumer spending, spurred by stronger income growth, the tax relief legislation of the past three years, the rise in stock market, and increased housing wealth. Spending on equipment and software could surge later this year as firms take advantage of the expensing provision scheduled to expire at year's end. To the extent that the timing of investment is shifted forward from 2005 to 2004, capital spending in early 2005 may be temporarily weakened. Businesses are also likely to add to their inventories in 2004, which were lean at the end of 2003.

The foreign sector may once again make at least a modest positive contribution to growth because of an expected pick up of economic activity abroad and the recent decline in the value of the dollar, both of which should help U.S. exports. From February 2002 to the end of 2003, the dollar declined 23 percent against the currencies of the major U.S. trading partners.

Residential investment may not maintain the exceptionally high levels reached in late 2003 and so may make little, if any, contribution to growth. The contribution to real GDP growth from Government spending is also likely to be at most modest. At the Federal level, growth in spending on security requirements will be partly offset by more moderate spending growth in areas of lower priority. At the State and local level, growth of outlays will continue to be restrained as these governments strive to achieve balanced budgets.

Real GDP and Unemployment: The economy is projected to grow 4.4 percent in 2004 measured on a calendar year-over-year basis, compared with 3.1 percent in 2003. During the next few years, real growth is

Table 11–1. ECONOMIC ASSUMPTIONS [1]

(Calendar years; dollar amounts in billions)

	Actual 2002	Projections						
		2003	2004	2005	2006	2007	2008	2009
Gross Domestic Product (GDP):								
Levels, dollar amounts in billions:								
Current dollars	10,446	10,939	11,566	12,139	12,746	13,396	14,096	14,831
Real, chained (1996) dollars	9,440	9,730	10,163	10,528	10,886	11,248	11,607	11,969
Chained price index (1996=100), annual average	110.7	112.4	113.8	115.3	117.1	119.1	121.4	123.9
Percent change, fourth quarter over fourth quarter:								
Current dollars	4.3	5.8	5.2	4.9	5.0	5.2	5.2	5.2
Real, chained (1996) dollars	2.9	4.2	4.0	3.4	3.3	3.3	3.1	3.1
Chained price index (1996=100)	1.3	1.5	1.2	1.4	1.6	1.8	2.0	2.0
Percent change, year over year:								
Current dollars	3.6	4.7	5.7	4.9	5.0	5.1	5.2	5.2
Real, chained (1996) dollars	2.4	3.1	4.4	3.6	3.4	3.3	3.2	3.1
Chained price index (1996=100)	1.1	1.6	1.2	1.3	1.5	1.7	2.0	2.0
Incomes, billions of current dollars:								
Corporate profits before tax	665	756	891	1,181	1,134	1,134	1,175	1,222
Wages and salaries	4,996	5,101	5,356	5,686	6,008	6,347	6,687	7,030
Other taxable income [2]	2,411	2,487	2,609	2,681	2,727	2,791	2,888	3,016
Consumer Price Index: [3]								
Level (1982–84=100), annual average	179.9	184.0	186.6	189.4	192.8	196.8	201.5	206.6
Percent change, fourth quarter over fourth quarter	2.2	2.0	1.4	1.6	1.9	2.2	2.5	2.5
Percent change, year over year	1.6	2.3	1.4	1.5	1.8	2.1	2.4	2.5
Unemployment rate, civilian, percent:								
Fourth quarter level	5.9	5.9	5.5	5.3	5.2	5.1	5.1	5.1
Annual average	5.8	6.0	5.6	5.4	5.2	5.1	5.1	5.1
Federal pay raises, January, percent:								
Military [4]	6.9	4.7	4.15	3.5	NA	NA	NA	NA
Civilian [5]	4.6	4.1	4.1	1.5	NA	NA	NA	NA
Interest rates, percent:								
91-day Treasury bills [6]	1.6	1.0	1.3	2.4	3.3	4.0	4.3	4.4
10-year Treasury notes	4.6	4.0	4.6	5.0	5.4	5.6	5.8	5.8
ADDENDUM: [7]								
Gross Domestic Product (GDP), revised:								
Levels, dollar amounts in billions:								
Current dollars	10,481	10,984	11,612	12,187	12,796	13,449	14,151	14,890
Real, chained (2000) dollars	10,083	10,397	10,858	11,248	11,630	12,017	12,401	12,788
Chained price index (2000=100), annual average	103.9	105.7	107.0	108.4	110.0	111.9	114.1	116.4
Percent change, fourth quarter over fourth quarter:								
Current dollars	4.2	5.9	5.2	4.9	5.0	5.2	5.2	5.2
Real, chained (2000) dollars	2.8	4.3	4.0	3.4	3.3	3.3	3.1	3.1
Chained price index (2000=100)	1.4	1.5	1.2	1.4	1.6	1.8	2.0	2.0
Percent change, year over year:								
Current dollars	3.8	4.8	5.7	4.9	5.0	5.1	5.2	5.2
Real, chained (2000) dollars	2.2	3.1	4.4	3.6	3.4	3.3	3.2	3.1
Chained price index (2000=100)	1.5	1.6	1.2	1.3	1.5	1.7	2.0	2.0
Incomes, billions of current dollars, revised:								
Corporate profits before tax	745	845	992	1,313	1,261	1,262	1,307	1,359
Wages and salaries	4,975	5,092	5,352	5,682	6,004	6,342	6,682	7,025
Other taxable income [2]	2,349	2,401	2,515	2,587	2,634	2,701	2,796	2,923

NA = Not Available.

[1] Based on information available as of late November 2003.

[2] Dividends, rent, interest and proprietors' income components of personal income.

[3] Seasonally adjusted CPI for all urban consumers.

[4] Percentages apply to basic pay only; 2002, 2003, and 2004 figures are averages of various rank- and longevity- specific adjustments; percentages to be proposed for years after 2005 have not yet been determined.

[5] Overall average increase, including locality pay adjustments. Percentages to be proposed for years after 2005 have not yet been determined.

[6] Average rate, secondary market (bank discount basis).

[7] Assumptions adjusted to reflect comprehensive revisions to GDP and incomes released by the Bureau of Economic Analysis in December 2003.

expected to exceed the long-run potential growth rate. As a result, the unemployment rate is projected to decline gradually from its 5.7 percent level in December 2003 to 5.1 percent in 2007. This rate is in the center of the range that is thought to be consistent with stable inflation.

Potential GDP: The growth of potential GDP is assumed to be 3.1 percent per year. Potential growth is approximately equal to the sum of the trend growth rates of the labor force and of productivity. The labor force is projected to grow about 1.0 percent per year on average, a combination of a 1.1 percent increase in the working-age population and a slight decline in the labor force participation rate. Trend productivity growth in the nonfarm business sector is assumed to average 2.3 percent per year, about the average during the past four decades, an extended period that encompasses rapid and slow productivity growth trends. The productivity assumption is a cautious one, especially in light of the 4.4 percent average growth rate in nonfarm productivity since the fourth quarter of 2000.

Inflation: Inflation is expected to edge up slightly from its low levels in 2003. The GDP chain-weighted price index is projected to increase 1.2 percent this year, rising to 2.0 percent in 2008 and 2009. The CPI is expected to increase 1.4 percent this calendar year, and then move up to 2.5 percent in 2009. The difference between inflation measured by the CPI and the GDP price index in the outyears is consistent with historical experience.

The forecast for low inflation in the coming years reflects the current very low inflation, the absence of inflationary expectations, the additional downward pressure on wages and prices that will persist until stronger growth eventually eliminates excess slack in the economy, and the demonstrated ability of the Federal Reserve in recent years to assure a reasonable degree of price stability. Not since the mid-1960s has there been a 10-year period with average inflation as low as is projected for 2000–2009.

Interest Rates: As is usual during an expansion, interest rates are projected to rise. The 3-month Treasury bill rate ended 2003 at 0.9 percent. It is expected to increase to 4.4 percent by 2009. The yield on the 10-year Treasury note ended last year at 4.3 percent. It is projected to increase to 5.8 percent by 2009.

The larger increase at the short end of the maturity spectrum than at the longer end is the usual cyclical experience and reflects an assumed less accommodative monetary policy as the expansion matures. Rates start from such a low level currently that, despite their projected increase, interest rates on average during 2003 through 2009 are likely to be lower than during any other seven-year period since the mid-1960s. Adjusted for inflation, the outyear real interest rates are close to their historical averages.

Income Shares: The share of taxable income in nominal GDP is projected to rise through 2005 and decline thereafter. The wage and salary share is projected to rise steadily through 2007 from a relatively low level in the third quarter of 2003. The share of the nontaxable component of labor compensation in GDP is expected to rise significantly over the forecast horizon. This component, called supplements to wages and salaries in the national income accounts, is composed of employer contributions for social insurance and employer-paid benefits, such as health insurance and pension contributions. Both health insurance and pension contributions are projected to rise more rapidly than taxable wages and salaries.

The cost of health insurance purchased by employers rose at a double-digit pace in both 2002 and 2003. Employers have shifted some of the rise in insurance costs on to employees, and are likely to continue to do so. Nonetheless, the upward pressure on the employers' share of insurance premiums is expected to be substantial. Also, employers' contributions to defined-benefit pension plans are expected to increase significantly over the next few years. Firms must reduce the large underfunding of plans created by the fall in the stock market between 2000 and 2003, lower assumed rates of return on fund assets, and the ongoing obligations for their workforce.

The share of corporate profits before tax will be affected by the strength of the economy and the end of the temporary expensing provisions for qualified capital by the end of 2004. Healthy economic growth will help sustain the corporate profits share. On the other hand, the expensing provision will lower profits before tax this year compared to what they otherwise would have been by allowing firms to write off more of their investment sooner. After 2004, however, corporate profits before tax will increase both because new investments will not qualify for the temporary expensing provision and because the remaining depreciation on expensed investments will be lower. Taking these various factors into account, the corporate profits share is expected to increase slightly this year, jump sharply in 2005 when the receipts payback for expensing will begin, and then decline gradually thereafter.

Among the other components of the tax base, the share of personal interest income in GDP is projected to decline significantly reflecting the relatively low nominal interest rates during the next six years. The remaining shares of the tax base (proprietors' income, rental income, and dividend income) are projected to remain relatively stable at around their 2003 levels.

Summary: The economic news since the assumptions were finalized has generally been favorable, although job growth in December fell well below expectations. On balance, at the start of 2004, the upside risks to the near-term forecast may exceed the downside risks. Moreover, if the strong productivity performance of recent years continues at even a somewhat more moderate pace, then long-run growth may also be stronger than assumed here. On the other hand, growth may also be weaker than forecast if, for example, the economy is subjected to additional and significant adverse shocks.

Comparison with CBO and Private-Sector Forecasts

In addition to the Administration, the Congressional Budget Office (CBO) and many private-sector forecasters also make economic projections. CBO develops its projections to aid Congress in formulating budget policy. In the executive branch, this function is performed jointly by the Treasury, the Council of Economic Advisers, and the Office of Management and Budget. Private-sector forecasts are often used by businesses for long-term planning. Table 11–2 compares the 2005 Budget assumptions with projections by the CBO and the Blue Chip Consensus, an average of about 50 private-sector forecasts.

The three sets of economic assumptions are based on different underlying assumptions concerning economic policies. The private-sector forecasts are based on their appraisals of the most likely policy outcomes, which vary among the forecasters. The Administration forecast assumes that all Budget proposals will be enacted. The CBO baseline projection assumes that current law as of the time the estimates are made will remain forever unchanged. Despite their differing policy assumptions, the three sets of economic projections, shown in Table 11–2, are very close. The similarity of the Budget economic projection to both the CBO baseline projection and the Consensus forecast underscores the cautious nature of the Administration forecast.

For real GDP, the Administration, CBO, and the Blue Chip consensus anticipate strong growth this year. The Administration projects 4.4 percent growth, slightly below the CBO and private sector consensus. For calendar year 2005, the Administration, at 3.6 percent, is again slightly below the Consensus (at 3.7 percent), and significantly less than CBO's 4.2 percent. Thereafter, the Administration's forecast remains close to the consensus growth rate. Over the six-year span as a whole, the Administration and the private sector consensus both project an average 3.5 percent annual growth rate, CBO 3.4 percent.

All three forecasts anticipate continued low inflation of between 1 and 2 percent as measured by the GDP chain-weighted price index, and between $1\frac{1}{2}$ and $2\frac{1}{2}$ percent as measured by the CPI. The unemployment rate projections are also similar. All three forecasts en-

Table 11–2. COMPARISON OF ECONOMIC ASSUMPTIONS

(Calendar years)

	Projections						Average,
	2004	2005	2006	2007	2008	2009	2004-09
GDP (billions of current dollars):							
CBO January	11,629	12,243	12,814	13,389	14,023	14,686	
Blue Chip Consensus January [2]	11,660	12,291	12,929	13,588	14,292	15,045	
2005 Budget	11,612	12,187	12,796	13,449	14,151	14,890	
Real GDP (chain-weighted): [1]							
CBO January	4.8	4.2	3.1	2.7	2.8	2.8	3.4
Blue Chip Consensus January [2]	4.6	3.7	3.3	3.1	3.2	3.2	3.5
2005 Budget	4.4	3.6	3.4	3.3	3.2	3.1	3.5
Chain-weighted GDP Price Index: [1]							
CBO January	1.1	1.1	1.5	1.8	1.9	1.9	1.5
Blue Chip Consensus January [2]	1.4	1.6	1.8	1.9	2.0	2.0	1.8
2005 Budget	1.2	1.3	1.5	1.7	2.0	2.0	1.6
Consumer Price Index (all-urban): [1]							
CBO January	1.6	1.7	2.0	2.2	2.2	2.2	2.0
Blue Chip Consensus January [2]	1.7	2.1	2.3	2.4	2.4	2.4	2.2
2005 Budget	1.4	1.5	1.8	2.1	2.4	2.5	2.0
Unemployment rate: [3]							
CBO January	5.8	5.3	5.0	5.1	5.2	5.2	5.3
Blue Chip Consensus January [2]	5.8	5.4	5.4	5.3	5.3	5.2	5.4
2005 Budget	5.6	5.4	5.2	5.1	5.1	5.1	5.3
Interest rates: [3]							
91-day Treasury bills:							
CBO January	1.3	3.0	4.0	4.6	4.6	4.6	3.7
Blue Chip Consensus January [2]	1.3	2.6	3.7	3.9	4.1	4.1	3.3
2005 Budget	1.3	2.4	3.3	4.0	4.3	4.4	3.3
10-year Treasury notes: [3]							
CBO January	4.6	5.4	5.5	5.5	5.5	5.5	5.3
Blue Chip Consensus January [2]	4.7	5.4	5.5	5.6	5.6	5.6	5.4
2005 Budget	4.6	5.0	5.4	5.6	5.8	5.8	5.4

Sources: Congressional Budget Office; Aspen Publishers, Inc., Blue Chip Economic Indicators
All forecasts adjusted to reflect December 2003 comprehensive revisions to the National Income and Product Accounts.

[1] Year over year percent change.

[2] January 2004 Blue Chip Consensus forecast for 2004 and 2005; Blue Chip October 2003 long run extension for 2006 - 2009.

[3] Annual averages, percent.

visage slightly rising interest rates during the next few years. For short-term rates, the consensus forecast is slightly below the Administration's in the outyears, while CBO is higher. The three long-term interest rate projections are very close.

Changes in Economic Assumptions

As shown in Table 11–3, the economic assumptions underlying this Budget have been revised significantly from those of the 2004 Budget.

Real GDP growth accelerated beyond expectation in the latter part of 2003 and for the year as a whole was a bit stronger, overall, than projected in last year's Budget. A year ago, the economic recovery appeared to be losing momentum; now, it is gaining speed. Consequently, the level of real GDP projected for this year is now a full percentage point higher than anticipated in last year's Budget, and the year-over-year growth rate is 0.8 percentage points higher. From 2005 onwards, moreover, real GDP growth in this budget is projected to be slightly above last year's projected rates.

The level of nominal GDP is projected to be about one percentage point higher in each year, 2004–2009, than in last year's budget. That is primarily because actual real GDP was significantly higher in 2003, and is now expected to grow slightly faster during 2004–2008, than in last year's budget. The unemployment rate is expected to be somewhat higher than in last year's assumptions but ultimately to decline to 5.1 percent, as before. Interest rates are projected to be lower during the next few years than was envisaged in last year's Budget, reflecting their current low levels. The short-term rate is expected to gradually approach last year's outyear assumptions, but long-term rates are now projected to be slightly higher. Adjusted for inflation, the real long-term rate is the same as in last year's budget.

Sources of Change in the Budget since Last Year

The sources of the change in the budget outlook from the 2004 Budget to the 2005 Budget are shown in Table 11–4. The second block shows that proposed and enacted legislation increases the deficit in 2004 and 2005 but has little effect thereafter.

The third block shows the effects on receipts and outlays from changes in economic assumptions. These include the effects of changes in assumptions for real growth, inflation, interest rates, unemployment, and the various taxable incomes.

Technical factors (block 4) are all changes in budget estimates that are not due to changes in economic assumptions or legislation. Examples of technical factors are revised demographic data from the 2000 Census and changes in estimating methodologies, including changes in the relationship between economic variables, income reported on tax returns, and actual tax collections.

Table 11–3. COMPARISON OF ECONOMIC ASSUMPTIONS IN THE 2004 AND 2005 BUDGETS

(Calendar years; dollar amounts in billions)

	2003	2004	2005	2006	2007	2008	2009
Nominal GDP:[1]							
2004 Budget assumptions	10,884	11,447	12,031	12,637	13,263	13,919	14,608
2005 Budget assumptions	10,939	11,566	12,139	12,746	13,396	14,096	14,831
Real GDP (1996 dollars):[1]							
2004 Budget assumptions	9,710	10,061	10,414	10,760	11,102	11,446	11,801
2005 Budget assumptions	9,730	10,163	10,528	10,886	11,248	11,607	11,969
Real GDP (percent change):[2]							
2004 Budget assumptions	2.9	3.6	3.5	3.3	3.2	3.1	3.1
2005 Budget assumptions	3.1	4.4	3.6	3.4	3.3	3.2	3.1
GDP price index (percent change):[2]							
2004 Budget assumptions	1.3	1.5	1.5	1.7	1.7	1.8	1.8
2005 Budget assumptions	1.6	1.2	1.3	1.5	1.7	2.0	2.0
Consumer Price Index (percent change):[2]							
2004 Budget assumptions	2.2	2.1	2.1	2.2	2.2	2.3	2.3
2005 Budget assumptions	2.3	1.4	1.5	1.8	2.1	2.4	2.5
Civilian unemployment rate (percent):[3]							
2004 Budget assumptions	5.7	5.5	5.2	5.1	5.1	5.1	5.1
2005 Budget assumptions	6.0	5.6	5.4	5.2	5.1	5.1	5.1
91-day Treasury bill rate (percent):[3]							
2004 Budget assumptions	2.0	3.6	4.3	4.4	4.4	4.5	4.5
2005 Budget assumptions	1.0	1.3	2.4	3.3	4.0	4.3	4.4
10-year Treasury note rate (percent):[3]							
2004 Budget assumptions	4.2	5.0	5.3	5.4	5.5	5.6	5.6
2005 Budget assumptions	4.0	4.6	5.0	5.4	5.6	5.8	5.8

[1] Not adjusted for December 2003 comprehensive revisions to the National Income and Product Accounts.
[2] Year over year.
[3] Calendar year average.

Table 11–4. SOURCES OF CHANGE IN BUDGET TOTALS

(In billions of dollars)

	2004	2005	2006	2007	2008	2009
(1) 2004 Budget						
Receipts	1,922	2,135	2,263	2,398	2,521	2,649
Outlays	2,229	2,343	2,464	2,576	2,711	2,843
Unified budget deficit (-)	–307	–208	–201	–178	–190	–194
(2) Changes due to policy:						
Receipts	–17	15	38	33	23	19
Outlays	92	62	34	39	27	14
Deficit increase (-), policy	–109	–48	4	–5	–5	4
(3) Changes due to economic assumptions:						
Receipts	–39	–37	–41	–27	–10	4
Outlays	–22	–37	–33	–24	–14	–6
Deficit increase (-), economic	–18	1	–8	–4	4	10
(4) Changes due to technical factors:						
Receipts	–68	–77	–55	–53	–48	–56
Outlays	19	31	8	–1	1	2
Deficit increase (-), technical	–87	–108	–63	–54	–48	–57
(5) Total changes from 2004 Budget:						
Receipts	–124	–99	–57	–47	–36	–33
Outlays	89	56	10	16	14	10
Total deficit increase (-)	–213	–155	–67	–63	–49	–43
(6) 2005 Budget						
Receipts	1,798	2,036	2,206	2,351	2,485	2,616
Outlays	2,319	2,400	2,473	2,592	2,724	2,853
Unified budget deficit (-)	–521	–364	–268	–241	–239	–237

Note: Changes in interest costs due to receipts changes included in outlay lines.

Structural and Cyclical Balances

When the economy is operating below potential and the unemployment rate exceeds the long-run sustainable average, as is projected to be the case for the next few years, receipts are lower than they would be if resources were more fully employed, and outlays for unemployment-sensitive programs (such as unemployment compensation and food stamps) are higher. As a result, the deficit is larger (or the surplus is smaller) than would be the case if the unemployment rate were at the sustainable long-run average. The portion of the deficit (or surplus) that can be traced to this factor is called the cyclical component. The portion that would remain if the unemployment rate was at its long-run value is called the structural deficit (or structural surplus).

The structural balance can often provide a clearer understanding of the stance of fiscal policy than the unadjusted budget balance including the cyclical component. The structural balance shows the surplus or deficit that will persist even when the economy is operating at the sustainable level of unemployment.

The estimates of the structural balance are based on the relationship between changes in the unemployment rate and real GDP growth on the one hand, and receipts and outlays on the other. As such, the relationships do not take into account other possible changes in the economy that might also be cyclically related. For example, the sharply rising stock market during the second half of the 1990s boosted capital gains-related receipts, and the subsequent fall in the stock market reduced receipts. Some of this rise and fall was cyclical in nature. It is not possible, however, to estimate this cyclical component accurately. As a result, both the unadjusted and structural balances are affected by cyclical stock market movements.

From 1998 to 2001, the unemployment rate appears to have been lower than could be sustained in the long run. Therefore, as shown in Table 11–5, in 1998 the structural surplus of $22 billion was less than the actual surplus of $69 billion. Likewise, in 1999–2001, the structural surplus continued to be smaller than the actual surplus, which was enlarged by the boost to receipts and the reduction in outlays associated with the low level of unemployment.

On the other hand, in 2002, the unemployment rate was above what is currently thought to be the sustainable level and the actual deficit of $158 billion exceeded the structural deficit of $104 billion. Similarly in 2003, the actual deficit of $375 billion contained a cyclical component of about $74 billion. The structural deficit for that year was $302 billion. As the projected unemployment rate declines toward the sustainable level in the next few years, the projected unadjusted deficit is expected to decline to be about equal to the structural deficit in 2007 and thereafter.

In the early 1990s, large swings in net outlays for deposit insurance (the saving and loan bailouts) had substantial impacts on deficits, but had little concurrent impact on economic performance. It therefore became customary to estimate an adjusted structural balance that removed deposit insurance outlays as well as the cyclical component of the budget balance from the actual balance. Deposit insurance net outlays are projected to be very small negative numbers in the coming years. Therefore, the adjusted structural deficit and the structural deficit are nearly identical over the forecast horizon.

Sensitivity of the Budget to Economic Assumptions

Both receipts and outlays are affected by changes in economic conditions. This sensitivity complicates budget planning because errors in economic assumptions lead to errors in the budget projections. It is therefore useful to examine the implications of possible changes in economic assumptions. Many of the budgetary effects of such changes are fairly predictable, and a set of rules of thumb embodying these relationships can aid in estimating how changes in the economic assumptions would alter outlays, receipts, and the surplus or deficit. These rules of thumb should be understood as suggesting orders of magnitude; they ignore a long list of secondary effects that are not captured in the estimates.

Economic variables that affect the budget do not usually change independently of one another. Output and employment tend to move together in the short run: a high rate of real GDP growth is generally associated with a declining rate of unemployment, while moderate or negative growth is usually accompanied by rising unemployment. In the long run, however, changes in the average rate of growth of real GDP are mainly due to changes in the rates of growth of productivity and labor force, and are not necessarily associated with changes in the average rate of unemployment. Inflation and interest rates are also closely interrelated: a higher expected rate of inflation increases interest rates, while lower expected inflation reduces rates.

Changes in real GDP growth or inflation have a much greater cumulative effect on the budget over time if they are sustained for several years than if they last for only one year. Highlights of the budgetary effects of the above rules of thumb are shown in Table 11–6.

For real growth and employment:

- As shown in the first block, if in 2004 for one year only, real GDP growth is lower by one percentage point and the unemployment rate permanently rises by one-half percentage point relative to the budget assumptions, the fiscal year 2004 deficit is estimated to increase by $12.2 billion; receipts in 2004 would be lower by $9.3 billion, and outlays would be higher by $2.9 billion, primarily for unemployment-sensitive programs. In fiscal year 2005, the estimated receipts shortfall would grow further to $20.8 billion, and outlays would increase by $7.4 billion relative to the base, even though the growth rate in calendar 2005 equaled the rate originally assumed. This is because the level of real (and nominal) GDP and taxable incomes would be permanently lower, and unemployment permanently higher. The budget effects (including growing interest costs associated with larger deficits) would continue to grow slightly in each successive year. During 2004–2009, the cumulative increase in the budget deficit is estimated to be $187 billion.
- The budgetary effects are much larger if the real growth rate is permanently reduced by one percentage point and the unemployment rate is unchanged, as shown in the second block. This scenario might occur if trend productivity were permanently lowered. In this example, during 2004–2009, the cumulative increase in the budget deficit is estimated to be $511 billion.
- The third block shows the effect of a one percentage point higher rate of inflation and one percentage point higher interest rates during calendar year 2004 only. In subsequent years, the price level and nominal GDP would be one percent higher than in the base case, but interest rates and future inflation rates are assumed to return to their base levels. In 2005, outlays would be above the base by $22.2 billion, due in part to lagged cost-of-living adjustments; receipts would rise $22.3 billion above the base, however, resulting in a $0.1 billion improvement in the budget balance. In subsequent years, the amounts added to receipts would continue to be larger than the additions to outlays. During 2004–2009, cumulative

Table 11–5. ADJUSTED STRUCTURAL BALANCE

(In billions of dollars)

	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Unadjusted surplus or deficit (–)	69.2	125.6	236.4	127.4	–157.8	–375.3	–520.7	–363.6	–267.6	–241.3	–239.0	–237.1
Cyclical component	47.5	72.8	110.2	49.0	–53.4	–73.6	–39.1	–15.3	–5.1	–1.4	–.1	....
Structural surplus or deficit (–)	21.7	52.7	126.3	78.4	–104.4	–301.7	–481.6	–348.3	–262.6	–239.9	–239.0	–237.1
Deposit insurance outlays	–4.4	–5.3	–3.1	–1.4	–1.0	–1.4	–1.5	–1.5	–1.0	–1.2	–1.9	–2.0
Adjusted structural surplus or deficit (–)	17.4	47.4	123.2	77.0	–105.5	–303.1	–483.1	–349.8	–263.6	–241.1	–240.8	–239.1

Note: The NAIRU is assumed to be 5.2% through calendar year 1998 and 5.1% thereafter.

budget deficits would be $23 billion smaller than in the base case.

- In the fourth block example, the rate of inflation and the level of interest rates are higher by one percentage point in all years. As a result, the price level and nominal GDP rise by a cumulatively growing percentage above their base levels. In this case, the effects on receipts and outlays mount steadily in successive years, adding $365 billion to outlays over 2004–2009 and $442 billion to receipts, for a net decrease in the 2004–2009 deficits of $78 billion.

The table also shows the interest rate and the inflation effects separately. These separate effects for interest rates and inflation rates do not sum to the effects for simultaneous changes in both. This occurs largely because the gains in budget receipts due to higher inflation result in higher debt service savings when interest rates are assumed to be higher as well (the combined case) than when interest rates are assumed to be unchanged (the separate case).

- The outlay effects of a one percentage point increase in interest rates alone is shown in the fifth block. The receipts portion of this rule-of-thumb is due to the Federal Reserve's deposit of earnings on its securities portfolio.
- The sixth block shows that a sustained one percentage point increase in the GDP chain-weighted price index and in CPI inflation decrease cumulative deficits by a substantial $257 billion during 2004–2009. This large effect is because the receipts from a higher tax base exceeds the combination of higher outlays from mandatory cost-of-living adjustments and lower receipts from CPI indexation of tax brackets.

The last entry in the table shows rules of thumb for the added interest cost associated with changes in the budget deficit.

The effects of changes in economic assumptions in the opposite direction are approximately symmetric to those shown in the table. The impact of a one percentage point lower rate of inflation or higher real growth would have about the same magnitude as the effects shown in the table, but with the opposite sign.

Table 11–6. SENSITIVITY OF THE BUDGET TO ECONOMIC ASSUMPTIONS

(In billions of dollars)

Budget effect	2004	2005	2006	2007	2008	2009	Total of Effects, 2004-2009
Real Growth and Employment							
Budgetary effects of 1 percent lower real GDP growth:							
(1) For calendar year 2004 only: [1]							
Receipts	–9.3	–20.8	–23.8	–24.9	–26.1	–27.5	–132.6
Outlays	2.9	7.4	7.8	9.7	12.0	14.3	54.1
Increase in deficit (–)	–12.2	–28.3	–31.6	–34.6	–38.2	–41.8	–186.7
(2) Sustained during 2004–2009, with no change in unemployment:							
Receipts	–9.5	–32.5	–61.1	–91.6	–124.7	–160.7	–480.1
Outlays	–0.1	0.1	1.4	4.5	9.4	15.7	31.0
Increase in deficit (–)	–9.3	–32.6	–62.5	–96.0	–134.1	–176.5	–511.1
Inflation and Interest Rates							
Budgetary effects of 1 percentage point higher rate of:							
(3) Inflation and interest rates during calendar year 2004 only:							
Receipts	10.6	22.3	22.8	21.6	22.7	23.9	123.9
Outlays	11.3	22.2	19.1	16.9	16.2	15.3	101.0
Decrease in deficit (+)	–0.6	0.1	3.7	4.7	6.5	8.6	22.9
(4) Inflation and interest rates, sustained during 2004–2009:							
Receipts	10.6	34.1	59.4	84.4	111.8	142.2	442.5
Outlays	11.5	34.3	53.9	71.3	88.2	105.7	364.8
Decrease in deficit (+)	–0.9	–0.1	5.6	13.1	23.6	36.5	77.7
(5) Interest rates only, sustained during 2004–2009:							
Receipts	1.8	4.4	5.7	6.4	7.0	7.7	33.0
Outlays	9.4	25.1	35.3	42.9	49.8	56.9	219.4
Increase in deficit (–)	–7.6	–20.7	–29.7	–36.5	–42.8	–49.2	–186.5
(6) Inflation only, sustained during 2004–2009:							
Receipts	8.8	29.6	53.6	77.7	104.4	134.0	408.2
Outlays	2.1	9.4	19.1	29.4	40.1	51.4	151.4
Decrease in deficit (+)	6.7	20.2	34.5	48.3	64.3	82.7	256.7
Interest Cost of Higher Federal Borrowing							
(7) Outlay effect of $100 billion increase in the 2004 unified deficit	0.6	2.2	3.4	4.3	5.1	5.5	21.2

* $50 million or less.

[1] The unemployment rate is assumed to be 0.5 percentage point higher per 1.0 percent shortfall in the level of real GDP.

12. STEWARDSHIP

Introduction

The budget is an essential tool for allocating resources within the Federal Government and between the public and private sectors; but current outlays, receipts, and the surplus or deficit do not provide enough information to evaluate fully the Government's financial and investment decisions. Indeed, changes in the annual budget deficit or surplus can be misleading indicators of the Government's financial condition. For example, the temporary shift from annual deficit to surplus in the late 1990s did nothing to correct the long-term deficiencies in the Nation's major entitlement programs, which are the major source of the long-run shortfall in Federal finances. This would have been more apparent if greater attention had focused on long-term measures such as appear in this chapter. As important as the current budget surplus or deficit is, other indicators are also needed to properly judge the Government's fiscal condition.

For the Federal Government, there is no single number that corresponds to the bottom line in a business balance sheet or income statement. The Government is ultimately judged by how its actions affect the country's security and well-being, and that cannot be summed up with a single statistic. Although its financial condition is important, the Government does not and is not expected to earn a profit. Instead, its fiscal status is best evaluated using a broad range of data and several complementary perspectives. This chapter presents a framework for such analysis. Because there are serious limitations on the available data and the future is uncertain, this chapter's findings should be interpreted with caution; its conclusions are subject to future revision.

The chapter consists of four parts:

- Part I explains how the separate pieces of analysis link together. Chart 12–1 presents the linkages in a schematic diagram.
- Part II presents the Government's physical and financial assets and its legal liabilities, which are all collected in Table 12–1. This table is similar to a business balance sheet, but for that reason it misses some of the Government's unique fiscal characteristics. That is why it needs to be supplemented by information in Parts III and IV.
- Part III shows possible paths for the Federal budget extending well beyond the normal budget window and describes how these projections vary depending on key economic and demographic assumptions. The projections are summarized in Table 12–2 and in a related set of charts. This part also presents discounted present value estimates of the funding shortfall in Social Security and Medicare in Table 12–3. Together such data indicate the full range of the Government's future responsibilities and resources under current law and policy. In particular, they show the looming challenge that Federal entitlement programs create for the budget in the long run.
- Part IV returns the focus to the present. It features information on national economic and social conditions that are affected by what the Government does. The private economy is the ultimate source of the Government's resources. Table 12–4 presents summary data for total national wealth, while highlighting the Federal investments that have contributed to that wealth. Table 12–5 presents a small sample of economic and social indicators.

PART I—HOW TO EVALUATE FEDERAL FINANCES

No single framework can encompass all of the factors that affect the financial condition of the Federal Government. Nor can any framework serve as a substitute for actual analysis. Nevertheless, the framework presented here offers a useful way to examine the financial aspects of Federal policies that goes beyond the standard measures of outlays, receipts and the surplus/deficit. It includes information that would appear on a balance sheet, but it goes beyond that to include long-run projections of the budget that can be used to show where future fiscal strains are most likely to appear. It also includes measures that indicate some of what society has gained economically and socially from Federal programs funded through this and past budgets.

The Government's legally binding obligations—its liabilities—consist in the first place of Treasury debt owed to the public. Other liabilities include the pensions and other benefits owed to retired Federal employees and veterans. These employee obligations are a form of deferred compensation; they have counterparts in the business world, and would appear as liabilities on a business balance sheet. Accrued obligations for Government insurance policies and the estimated present value of failed loan guarantees and deposit insurance claims are also analogous to private liabilities. These Government liabilities are discussed further in Part II along with the Government's assets. They are collected in Table 12–1. Although they are important, the obligations shown in Table 12–1 are only a subset of the Government's total financial responsibilities. Indeed, the full extent of the Government's fiscal exposure through its various programmatic commitments dwarfs the outstanding debt held by the public or even the total of all acknowledged Federal liabilities. The commitment to Social Security and Medicare alone amounts to many times the value of outstanding Federal debt.

In addition to Social Security and Medicare, the Government has a broad range of programs that dispense cash and other benefits to individual recipients. It also provides a wide range of other public services that must be financed through the tax system. The Government is not constitutionally obligated to continue operating any of these programs without change, and specific benefits and services may be modified or even ended at any time, subject to the decisions of Congress and the President. Indeed, such changes are a regular part of the legislative cycle. For such reasons, these programmatic commitments are not "liabilities" in a legal or accounting sense, and they would not appear on a balance sheet, but they remain Federal responsibilities and will have a claim 'on budgetary resources for the foreseeable future. All of these programs are reflected in the long-run budget projections in Part III. It would be misleading to leave out any of these programmatic commitments in projecting future claims on the Government or in calculating the Government's long-run fiscal balance.

The Federal Government also has resources that go beyond the assets that would appear on a business's balance sheet. These additional resources include most importantly the Government's sovereign power to tax. Because of these additional responsibilities and resources, the best way to analyze the future strains on the Government's fiscal position is to make a long-run projection of the entire Federal budget, as is done in Part III of this chapter, which provides a comprehensive measure of the Government's future cash flows.

Over long periods of time, the spending the Government does must be financed by the taxes and other receipts it collects. Although the Government can borrow for temporary periods, it must pay interest on any such borrowing, which adds to future spending. In the long run, under normal financial conditions, a solvent Government must pay for its spending out of its receipts. The projections in Part III show that under an extension of the estimates in this budget, long-run balance in this sense is not achieved, mostly because projected spending for Social Security, Medicare, and Medicaid grow faster than the revenue available to pay for them.

The long run budget projections and the table of assets and liabilities are silent on the question of whether the public is receiving value for its tax dollars or whether Federal assets are being used effectively. Information on those points requires performance measures for Government programs supplemented by appropriate information about conditions in the economy and society. Recent changes in budgeting practices will contribute to the goal of more complete information about Government programs and permit a closer alignment of the cost of programs with performance measures. These changes are described in detail in the main *Budget* volume itself, in chapter 2 of this volume, and in the accompanying material that describes results obtained with the Program Assessment Rating Tool (PART). This Stewardship chapter complements the detailed exploration of Government performance with an assessment of the overall impact of Federal policy as reflected in some general measures of economic and social well-being.

Relationship with FASAB Objectives

The framework presented here meets the stewardship objective[1] for Federal financial reporting recommended by the Federal Accounting Standards Advisory Board (FASAB) and adopted for use by the Federal Government in September 1993.

> *Federal financial reporting should assist report users in assessing the impact on the country of the Government's operations and investments for the period and how, as a result, the Government's and the Nation's financial conditions have changed and may change in the future. Federal financial reporting should provide information that helps the reader to determine:*
>
> *3a. Whether the Government's financial position improved or deteriorated over the period.*
>
> *3b. Whether future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due.*
>
> *3c. Whether Government operations have contributed to the nation's current and future well-being.*

The presentation here is an experimental approach for meeting this objective at the Government-wide level. It is especially intended to meet the broad interests of economists and others in evaluating trends over time, including both past and future trends. The annual *Financial Report of the United States Government* presents related information, but from a different perspective. The *Financial Report* includes a standard business-type balance sheet. The assets and liabilities on that balance sheet are all based on transactions that have already occurred. A somewhat similar table can be found in Part II of this chapter. The *Report* also includes a Statement of Social Insurance and it reviews a substantial body of information on the condition and sustainability of the Government's social insurance programs. However, the *Report* does not try to extend that review to the condition or sustainability of the Government as a whole, which is the main focus of this chapter.

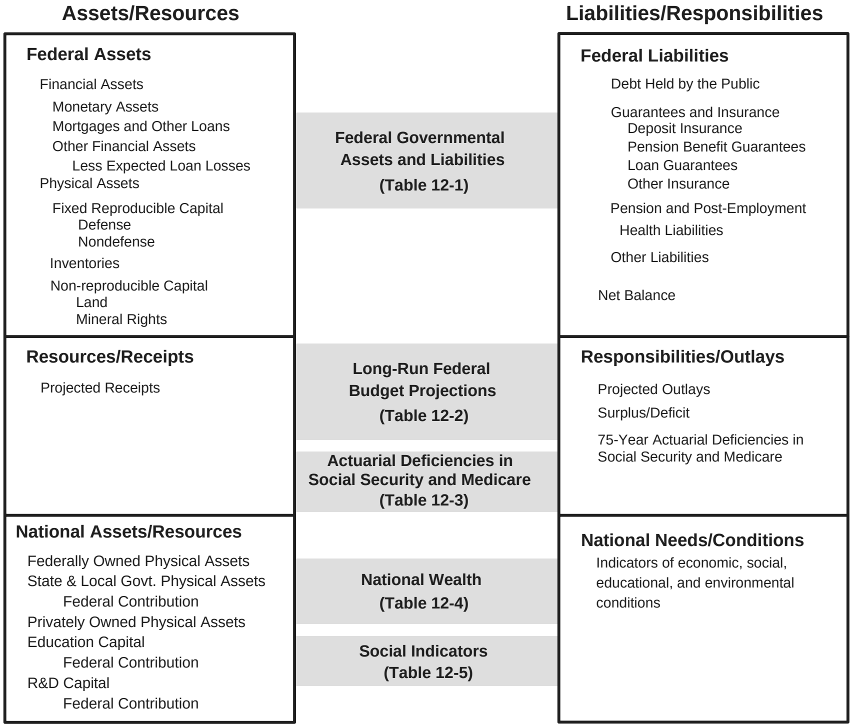
Connecting the Dots: The presentation that follows consists in large part of a series of tables and charts. Taken together, they serve similar functions to a business's balance sheet. The schematic diagram, Chart 12–1, shows how the different pieces fit together. The tables and charts should be viewed as an ensemble, the main elements of which are grouped in two broad

[1] Statement of Federal Financial Accounting Concepts, Number 1, *Objectives of Federal Financial Reporting,* September 2, 1993. Other objectives are budgetary integrity, operting performance, and systems and controls.

categories—assets/resources and liabilities/responsibilities.

- Reading down the left-hand side of Chart 12–1 shows the range of Federal resources, including assets the Government owns, tax receipts it can expect to collect based on current and proposed law, and national wealth that provides the base for Government revenues.
- Reading down the right-hand side reveals the full range of Federal obligations and responsibilities, beginning with Government's acknowledged liabilities based on past actions, such as the debt held by the public, and going on to include future budget outlays that maintain present policies and trends. This column ends with a set of indicators highlighting areas where Government activity affects society or the economy.

Chart 12-1. A Presentation of the Federal Government's Financial Condition


Assets/Resources
Liabilities/Responsibilities
Federal Assets
Financial Assets
Monetary Assets
Mortgages and Other Loans
Other Financial Assets
Less Expected Loan Losses
Physical Assets
Fixed Reproducible Capital
Defense
Nondefense
Inventories
Non-reproducible Capital
Land
Mineral Rights
Federal Governmental Assets and Liabilities (Table 12-1)
Federal Liabilities
Debt Held by the Public
Guarantees and Insurance
Deposit Insurance
Pension Benefit Guarantees
Loan Guarantees
Other Insurance
Pension and Post-Employment Health Liabilities
Other Liabilities
Net Balance
Resources/Receipts
Projected Receipts
Long-Run Federal Budget Projections (Table 12-2)
Actuarial Deficiencies in Social Security and Medicare (Table 12-3)
Responsibilities/Outlays
Projected Outlays
Surplus/Deficit
75-Year Actuarial Deficiencies in Social Security and Medicare
National Assets/Resources
Federally Owned Physical Assets
State & Local Govt. Physical Assets
Federal Contribution
Privately Owned Physical Assets
Education Capital
Federal Contribution
R&D Capital
Federal Contribution
National Wealth (Table 12-4)
Social Indicators (Table 12-5)
National Needs/Conditions
Indicators of economic, social, educational, and environmental conditions

QUESTIONS AND ANSWERS ABOUT THE GOVERNMENT'S STEWARDSHIP

1. According to Table 12–1, the Government's liabilities exceed its assets. No business could operate in such a fashion. Why does the Government not manage its finances more like a business?

The Federal Government has fundamentally different objectives from a business enterprise. The primary goal of every business is to earn a profit, and the Federal Government properly leaves almost all activities at which a profit could be earned to the private sector. For the vast bulk of the Federal Government's operations, it would be difficult or impossible to charge prices—let alone prices that would cover expenses. The Government undertakes these activities not to improve its balance sheet, but to benefit the Nation.

For example, the Federal Government invests in education and research. The Government earns no direct return from these investments; but people are made richer if they are successful. The returns on these investments show up not as an increase in the Government assets but as an increase in the general state of knowledge and in the capacity of the country's citizens to earn a living and lead a fuller life. A business's motives for investment are quite different; business invests to earn a profit for itself, not others, and if its investments are successful, their value will be reflected in its balance sheet. Because the Federal Government's objectives are different, its balance sheet behaves differently, and should be interpreted differently.

2. Table 12–1 seems to imply that the Government is insolvent. Is it?

No. Just as the Federal Government's responsibilities are of a different nature than those of a private business, so are its resources. Government solvency must be evaluated in different terms.

What the table shows is that those Federal obligations that are most comparable to the liabilities of a business corporation exceed the estimated value of the assets actually owned by the Federal Government. The Government, however, has access to other resources through its sovereign powers. These powers, which include taxation, allow the Government to meet its present obligations and those that are anticipated from future operations even though the Government's current assets are less than its current liabilities.

The financial markets clearly recognize this reality. The Federal Government's implicit credit rating is the best in the world; lenders are willing to lend it money at interest rates substantially below those charged to private borrowers. This would not be true if the Government were really insolvent or likely to become so. Where governments totter on the brink of insolvency, lenders are either unwilling to lend them money, or do so only in return for a substantial interest premium.

QUESTIONS AND ANSWERS ABOUT THE GOVERNMENT'S STEWARDSHIP

3. Why are Social Security and Medicare not shown as Government liabilities in Table 12–1?

Future Social Security and Medicare benefits may be considered as promises or responsibilities of the Federal Government, but these benefits are not a liability in a legal or accounting sense. The Government has unilaterally decreased as well as increased these benefits in the past, and future reforms could alter them again. These benefits are not ignored in this presentation of the Government's finances, but they are shown elsewhere than in Table 12–1. They appear in two ways: Budget projections as a percent of GDP from now through 2080, in Table 12–2, and the actuarial deficiency estimates over roughly the same period in Table 12–3.

Other Federal programs exist that are similar to Social Security and Medicare in the promises they make— Medicaid—for example. Few have suggested counting the future benefits expected under these programs as Federal liabilities, yet it would be difficult to justify a different accounting treatment for them if Social Security or Medicare were to be classified as a liability. There is no bright line dividing Social Security and Medicare from other programs that promise benefits to people, and all the Government programs that do so should be accounted for similarly.

Furthermore, if future Social Security or Medicare benefits were to be treated as a liability, then future payroll tax receipts earmarked to finance those benefits ought to be treated as a Government asset. This treatment would be essential to correctly gauge the future claim. Tax receipts, however, are not generally considered Government assets, and for good reason: the Government does not own the wealth on which future taxes depends. Including taxes on the balance sheet would be wrong for this reason, but without counting taxes the balance sheet would overstate the drain on net assets from Social Security and Medicare. Furthermore, treating taxes for Social Security or Medicare differently from other taxes would be highly questionable.

Finally, under Generally Accepted Accounting Principles (GAAP), Social Security is not considered to be a liability, so not counting it as such in this chapter is consistent with the accounting standards.

4. Why can't the Government keep a better set of books?

The Government is not a business, and accounting standards designed to illuminate how much a business earns and how much equity it has could provide misleading information if applied naively to the Government. The Government does not have a "bottom line" comparable to that of a business corporation, but the Federal Accounting Standards Advisory Board (FASAB) has developed, and the Government has adopted, a conceptual accounting framework that reflects the Government's distinct functions and answers many of the questions for which Government should be accountable. This framework addresses budgetary integrity, operating performance, stewardship, and systems and controls. FASAB has also developed, and the Government has adopted, a full set of accounting standards. Federal agencies now issue audited financial reports that follow these standards and an audited Government-wide financial report is issued as well. In short, the Federal Government does follow generally accepted accounting principles (GAAP) just as businesses and State and local governments do for their activities, although the relevant principles differ depending on the circumstances. This chapter is intended to address the "stewardship objective"—assessing the interrelated condition of the Federal Government and the Nation. The data in this chapter illuminate the trade-offs and connections between making the Federal Government "better off" and making the Nation "better off."

QUESTIONS AND ANSWERS ABOUT THE GOVERNMENT'S STEWARDSHIP

5. When the baby-boom generation begins to retire in large numbers beginning within the next ten years, the deficit could become much larger than it ever was before. Should this not be reflected in evaluating the Government's financial condition?

The aging of the U.S. population will become dramatically evident when the baby-boomers begin to retire, and this demographic transition poses serious long-term problems for Federal entitlement programs and the budget. Both the long-range budget projections and the actuarial projections presented in this chapter indicate how serious the problem is. It is clear from this information that reforms are needed in these programs to meet the long-term challenges.

6. Would it make sense for the Government to borrow to finance needed capital—permitting a deficit in the budget—so long as the borrowing did not exceed the amount spent on investments?

This rule might not actually permit much extra borrowing. If the Government were to finance new capital by borrowing, it should plan to pay off the debt incurred to finance old capital as the capital is used up. The net new borrowing permitted by this rule would not then exceed the amount of net investment the government does after adjusting for capital consumption. But, as discussed in Chapter 6, Federal net investment in physical capital is usually not very large and has even been negative, so little if any deficit spending would have been justified by this borrowing-for-investment criterion, at least in recent years.

The Federal Government also funds substantial amounts of physical capital that it does not own, such as highways and research facilities, and it funds investment in intangible "capital" such as education and training and the conduct of research and development. A private business would never borrow to spend on assets that would be owned by someone else. However, such spending is today a principal function of Government. It is not clear whether this type of capital investment would fall under the borrowing-for-investment criterion. Certainly, these investments do not create assets owned by the Federal Government, which suggests they should not be included for this purpose, even though they are an important part of national wealth.

There is another difficulty with the logic of borrowing to invest. Businesses expect investments to earn a return large enough to cover their cost. In contrast, the Federal Government does not generally expect to receive a direct payoff from its investments, whether or not it owns them. In this sense, investments are no different from other Government expenditures, and the fact that they provide services over a longer period of time is no justification for excluding them when calculating the surplus or deficit.

Finally, the Federal Government must pursue policies that support the overall economic well-being of the Nation and its security interests. For such reasons, the Government may deem it desirable to run a budget surplus, even if this means paying for its own investments from current receipts, and there are times when it is necessary to run a deficit, even one that exceeds Government net investment. Considerations in addition to the size of Federal investment must be weighed in choosing the right level of the surplus or deficit.

PART II—THE FEDERAL GOVERNMENT'S ASSETS AND LIABILITIES

Table 12–1 takes a backward look at the Government's assets and liabilities summarizing what the Government owes as a result of its past operations netted against the value of what it owns. The table gives some perspective by showing these net asset figures for a number of years beginning in 1960. To ensure comparability across time, the assets and liabilities are measured in terms of constant FY 2003 dollars. Government liabilities have exceeded the value of assets (see chart 12–2) over this entire period, but, in the late 1970s, a speculative run-up in the prices of oil and other real assets temporarily boosted the value of Federal holdings. When those prices subsequently declined, Federal asset values declined and only recently have they regained the level they had reached temporarily in the mid-1980s.

Currently, the total real value of Federal assets is estimated to be 50 percent greater than it was in 1960. Meanwhile, Federal liabilities have increased by over 200 percent in real terms. The decline in the Federal net asset position has been due partly to persistent Federal budget deficits that have boosted debt held by the public most years since 1960. Other factors have also been important in reducing net Federal assets such as the large increases in health benefits for Federal retirees and the sharp rise in veterans' disability compensation. The slower growth in Federal assets compared with liabilities also helped reduce the net asset position.

The shift from budget deficits to budget surpluses in the late 1990s temporarily checked the decline in Federal net assets, but only for a few years. Currently, the net excess of liabilities over assets is about $4.9 trillion or nearly $17,000 per capita. As a ratio to GDP, the excess of liabilities over assets reached a peak of 51 percent in 1995; it declined to 38 percent in 2000 and was 45 percent in 2003. The average since 1960 has been 34 percent.

Assets

Table 12–1 offers a comprehensive list of the financial and physical resources owned by the Federal Government.

Financial Assets: According to the Federal Reserve Board's Flow-of-Funds accounts, the Federal Government's holdings of financial assets amounted to $0.6 trillion at the end of FY 2003. Government-held mortgages and other loans (measured in constant dollars) reached a peak in the early 1990s as the Government acquired mortgages from savings and loan institutions that had failed. The Government subsequently liquidated most of the mortgages it acquired from bankrupt savings and loans in the 1990s. The face value of mortgages and other loans overstates their economic worth. OMB estimates that the discounted present value of future losses and interest subsidies on these loans was about $40 billion as of 2003. These estimated losses are subtracted from the face value of outstanding loans to obtain a better estimate of their economic worth.

Reproducible Capital: The Federal Government is a major investor in physical capital and computer software. Government-owned stocks of such capital have amounted to about $1.0 trillion in constant dollars for most of the last 40 years (OMB estimate). This capital consists of defense equipment and structures, including weapons systems, as well as nondefense capital goods. Currently, slightly less than two-thirds of the capital is defense equipment or structures. In 1960, defense capital was about 90 percent of the total. In the 1970s, there was a substantial decline in the real value of U.S. defense capital and there was another large decline in the 1990s after the end of the Cold War. Meanwhile, nondefense Federal capital has increased at an average annual rate of around 2–1/2 percent. The Government also holds inventories of defense goods and other items that in 2003 amounted to about 20 percent of the value of its fixed capital.

Non-reproducible Capital: The Government owns significant amounts of land and mineral deposits. There are no official estimates of the market value of these holdings (and of course, in a realistic sense, many of these resources would never be sold). Researchers in the private sector have estimated what they are worth, however, and these estimates are extrapolated in Table 12–1. Private land values fell sharply in the early 1990s, but they have risen since 1993. It is assumed here that Federal land shared in the decline and the subsequent recovery. Oil prices have been on a roller coaster since the mid-1990s. They declined sharply in 1997–1998, rebounded in 1999–2000, fell again in 2001, and rose in 2002–2003. These fluctuations have caused the estimated value of Federal mineral deposits to fluctuate as well. In 2003 as estimated here, the real value of Federal land and mineral rights was higher than at any time since 1982.

These estimates are limited to land and mineral rights. They, thus, omit some valuable assets owned by the Federal Government, such as works of art and historical artifacts partly because there is no realistic basis for valuing such unique assets and also because, as part of the Nation's historical heritage, these objects are never likely to be sold.

Total Assets: The total value of Government assets measured in constant dollars has been increasing for the past five years, but it was still lower in 2003 than it was in the early 1980s. The Government's asset holdings are vast. As of the end of FY 2003, Government assets were estimated to be worth about $3.0 trillion, about 27 percent of GDP.

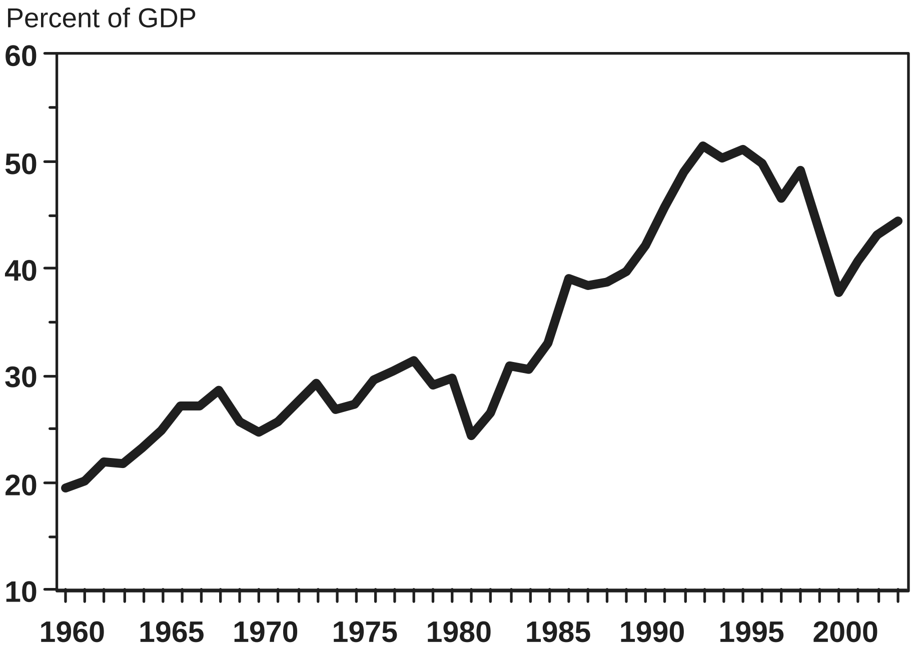
Table 12–1. GOVERNMENT ASSETS AND LIABILITIES*

(As of the end of the fiscal year, in billions of 2003 dollars)

	1960	1965	1970	1975	1980	1985	1990	1995	2000	2001	2002	2003
ASSETS												
Financial Assets:												
Cash and Checking Deposits	44	63	39	32	49	32	43	44	59	52	79	53
Other Monetary Assets	1	1	1	1	2	2	2	1	7	12	19	9
Mortgages	28	27	40	42	78	80	102	70	81	78	76	74
Other Loans	104	143	179	179	230	301	214	163	137	129	121	118
less Expected Loan Losses	–1	–3	–5	–9	–18	–18	–20	–25	–39	–39	–46	–47
Other Treasury Financial Assets	63	79	69	62	87	129	206	247	226	241	258	292
Total	239	310	324	307	428	526	546	511	539	553	603	589
Nonfinancial Assets:												
Fixed Reproducible Capital:	1,030	1,021	1,062	1,029	974	1,102	1,143	1,149	1,007	994	992	998
Defense	890	836	845	772	693	806	827	808	661	640	630	631
Nondefense	140	185	217	257	281	297	316	341	346	354	362	367
Inventories	274	237	221	197	244	279	247	191	196	190	195	194
Nonreproducible Capital:	443	455	436	646	1,035	1,110	876	666	998	1,058	1,045	1,202
Land	96	133	168	266	340	353	363	282	438	457	526	553
Mineral Rights	347	322	268	380	696	757	513	384	560	601	519	649
Subtotal	1,747	1,713	1,719	1,873	2,254	2,491	2,267	2,005	2,200	2,241	2,232	2,394
Total Assets	**1,986**	**2,023**	**2,043**	**2,180**	**2,682**	**3,018**	**2,813**	**2,515**	**2,739**	**2,795**	**2,835**	**2,984**
LIABILITIES												
Debt held by the Public	1,194	1,228	1,093	1,111	1,381	2,284	3,112	4,135	3,601	3,423	3,600	3,915
Insurance and Guarantee Liabilities:												
Deposit Insurance	....	....	....	....	2	10	75	5	1	3	2	1
Pension Benefit Guarantee	....	....	....	45	33	45	45	22	43	53	82	71
Loan Guarantees	*	1	2	7	13	11	16	31	39	40	38	36
Other Insurance	33	29	23	21	28	17	21	18	17	16	16	16
Subtotal	33	30	25	73	76	83	157	76	100	112	139	124
Pension and Post-Employment Health Liabilities:												
Civilian and Military Pensions	836	1,051	1,256	1,423	1,889	1,874	1,832	1,776	1,810	1,819	1,861	1,886
Retiree Health Insurance Benefits	200	252	301	341	453	449	439	426	406	795	820	842
Veterans Disability Compensation	198	249	298	330	339	280	252	275	584	713	863	955
Subtotal	1,234	1,552	1,855	2,094	2,680	2,603	2,523	2,477	2,800	3,328	3,544	3,684
Other Liabilities:												
Trade Payables and Miscellaneous	29	35	44	56	86	112	154	128	104	106	104	116
Benefits Due and Payable	21	26	35	43	53	66	74	80	82	89	97	99
Subtotal	50	61	79	99	138	178	228	208	187	195	201	215
Total Liabilities	**2,511**	**2,870**	**3,052**	**3,377**	**4,276**	**5,148**	**6,020**	**6,896**	**6,687**	**7,058**	**7,484**	**7,937**
Net Assets (Assets Minus Liabilities)	**–525**	**–847**	**–1,009**	**–1,197**	**–1,594**	**–2,130**	**–3,207**	**–4,380**	**–3,948**	**–4,263**	**–4,649**	**–4,953**
Addenda:												
Net Assets Per Capita (in 2003 dollars)	–2,911	–4,365	–4,929	–5,550	–6,988	–8,921	–12,797	–16,406	–13,958	–14,908	–16,084	–16,961
Ratio to GDP (in percent)	–19.8	–25.4	–25.3	–26.5	–29.5	–33.0	–42.5	–51.4	–37.9	–41.0	–43.4	–44.6

*This Table shows assets and liabilities for the Government as a whole, excluding the Federal Reserve System. Data for 2003 are extrapolated in some cases.

Chart 12-2. Net Federal Liabilities



Liabilities

Table 12–1 includes Federal liabilities that would also be listed on a business balance sheet. All the various forms of publicly held Federal debt are counted, as are Federal pension and health insurance obligations to civilian and military retirees and the disability compensation that is owed the Nation's veterans. The estimated liabilities stemming from Federal insurance programs and loan guarantees are also shown. The benefits that are due and payable under various Federal programs are also included, but these are short-term obligations not long-term responsibilities.

Other obligations, including future benefit payments that are likely to be made through Social Security and other Federal income transfer programs, are not shown in this table. These are not Federal liabilities in a legal or accounting sense. They are Federal responsibilities, and it is important to gauge their size, but they are not binding in the same way that a liability is. That is why a simple balance sheet can give a misleading impression of the Federal financial position. The budget projections and other data in Part III are designed to provide a sense of these broader responsibilities and their claim on future budgets.

Debt Held by the Public: The Federal Government's largest single liability is the debt owed to the public. It amounted to about $3.9 trillion at the end of 2003, down from a peak value of $4.2 trillion (in constant 2003 dollars) in 1996. Publicly held debt declined for several years in the late 1990s because of the unified budget surplus that had emerged at that time, but as the deficit has returned, publicly held debt has begun to increase again, while remaining below its previous peak level measured in real terms.

Insurance and Guarantee Liabilities: The Federal Government has contingent liabilities arising from the loan guarantees it has made and its insurance programs. When the Government guarantees a loan or offers insurance, cash disbursements are often small initially, and if a fee is charged, the Government may even collect money; but the risk of future cash payments associated with such commitments can be large. The figures reported in Table 12–1 are estimates of the current discounted value of prospective future losses on outstanding guarantees and insurance contracts. The present value of all such losses taken together is about $0.1 trillion. As is true elsewhere in this chapter, this estimate does not incorporate the market value of the risk associated with these contingent liabilities; it merely reflects the present value of expected losses. Although individually many of these programs are large and potential losses can be a serious concern, relative to total Federal liabilities or even the total debt held by the public, these insurance and guarantee liabilities are fairly small. They were less than 2 percent of total liabilities in 2003.

Pension and Post-Employment Health Liabilities: The Federal Government owes pension benefits as a form of deferred compensation to retired workers and to current employees who will eventually retire. It also provides civilian retirees with subsidized health insurance through the Federal Employees Health Benefits program and military retirees receive similar benefits. Veterans are owed compensation for their service related disabilities. While the Government's employee pension obligations have risen slowly, there has been a sharp increase in the liability for future health benefits and veterans compensation. The discounted present value of all these benefits was estimated to be around $3.7 trillion at the end of FY 2003 up from $2.8 trillion in 2000.[2] There was a large expansion in Federal military retiree health benefits legislated in 2001.

Net Assets

The Government need not maintain a positive balance of net assets to assure its fiscal solvency, and the buildup in net liabilities since 1960 has not significantly damaged Federal creditworthiness. Long-term Government interest rates in 2003 reached their lowest levels in 45 years, although by year end rates were substantially above their low point in May. For the year as a whole, the average level of long term rates were lower than in any year since 1963. Despite the continued good performance of interest rates, there are limits to how much debt the Government can assume without putting its finances in jeopardy. Over an extended time horizon, the Federal Government must take in enough revenue to cover all of its spending including debt service. A Government that borrows must eventually pay for what it has borrowed. The Government's ability to service its debt in the long run, however, cannot be gauged from a balance sheet alone. To judge the prospects for long-run solvency it is necessary to project the budget into the future.

PART III—THE LONG-RUN BUDGET OUTLOOK

A balance sheet with its focus on obligations arising from past transactions can only show so much information. For the Government, it is important to anticipate what future budgetary requirements might flow from future transactions as implied by current law. Despite their uncertainty, very long-run budget projections can be useful in sounding warnings about potential problems. Federal responsibilities extend well beyond the next five or ten years, and problems that may be small in that time frame can become much larger if allowed to grow.

Programs like Social Security and Medicare are intended to continue indefinitely, and so long-range projections for Social Security and Medicare have been prepared for decades. Budget projections for individual programs, even ones as important as Social Security and Medicare, do not reveal the Government's overall budgetary position. Only by projecting the entire budget is it possible to anticipate whether sufficient resources will be available to meet all the anticipated requirements for individual programs. It is also necessary to estimate how the budget's future growth compares with that of the economy to judge how well the economy might be able to support future budgetary needs.

To assess the overall financial condition of the Government, it is necessary to examine the future prospects for all Government programs including the revenue sources that support Government spending. Such an assessment reveals that the key drivers of the long-range deficit are, not surprisingly, Social Security and Medicare along with Medicaid, the Federal program that helps States provide health coverage for low-income people and nursing home care for the elderly. Medicaid, like Medicare and Social Security, is projected to grow more rapidly than the economy over the next several decades and to add substantially to the overall budget deficit. Under current law, there is no offset anywhere in the budget that is large enough to cover all the demands that will eventually be imposed by Social Security, Medicare, and Medicaid.

Future budget outcomes depend on a host of unknowns—constantly changing economic conditions, unforeseen international developments, unexpected demographic shifts, the unpredictable forces of technological advance, and evolving political preferences to name a few. The uncertainty increases the further into the future projections are extended. Such uncertainty, while making accuracy more difficult, actually *enhances* the importance of long-term projections. People are generally averse to risk, but it is not possible to assess the likelihood of future risks without projections. Although a full treatment of risks is beyond the scope of this chapter, the chapter is able to show how the budget projections respond to changes in some of the key economic and demographic parameters. Given the uncertainties, the best that can be done is to work out the implications of expected developments on a "what if" basis.

The Impending Demographic Transition

In 2008, the first members of the huge generation born after World War II, the so-called baby-boomers, will reach age 62 and become eligible for early retirement under Social Security. In the years that follow, the elderly population will skyrocket, putting serious strains on the budget because of increased expenditures for Social Security and for the Government's health programs serving this population.

The pressures are expected to persist even after the baby-boomers are gone. The Social Security actuaries project that the ratio of workers to Social Security beneficiaries will fall from around 3½ currently to a little over 2 by the time most of the baby-boomers have retired. Because of lower fertility and improved mortality, that ratio is expected to continue to decline slowly from there. With fewer workers to pay the taxes needed to

[2] The pension liability is the actuarial present value of benefits accrued-to-date based on past and projected salaries. The 2003 liability was extrapolated. The retiree health insurance liability is based on actuarial calculations of the present value of benefits promised under existing programs. Estimates are only available since 1997. For earlier years the liability was assumed to grow in line with the pension liability, and for that reason may differ significantly from what the actuaries would have calculated for this period. Veterans' disability compensation was taken from the *2002 Financial Report of the United States Government* and *Reports from earlier years.*

support the retired population, the budgetary pressures will continue to grow. The problem posed by the demographic transition is a permanent and a growing one.

Currently, the three major entitlement programs—Social Security, Medicare and Medicaid—account for 43 percent of non-interest Federal spending, up from 30 percent in 1980. By 2040, when most of the remaining baby-boomers will be in their 80s, these three programs could easily account for 70 percent of non-interest Federal spending. At the end of the projection period, the figure rises to nearly 80 percent of non-interest spending. In other words, under an extension of current-law formulas and the policies in the budget, almost all of the budget would go to these three programs alone. That would severely reduce the flexibility of the budget, and the Government's ability to respond to new challenges.

An Unsustainable Path

These long-run budget projections show clearly that the budget is on an unsustainable path, although the rise in the deficit unfolds gradually. The budget deficit is projected to decline as the economy expands over the next several years, while most of the baby-boomers will remain in the work force. As the baby-boomers begin to reach retirement age in large numbers, the deficit begins to rise steadily. This process is projected to begin about 10 years from now, i.e., in about 10 years, the deficit as a share of GDP reaches a low point and then begins an inexorable increase. By the end of the projection period for this chapter in 2080, rising deficits would drive publicly held Federal debt to levels several times the size of GDP.

The revenue projections in this section start with the budget's estimate of receipts under the Administration's proposals. They assume that individual income tax receipts will rise somewhat relative to GDP. This increase reflects the higher marginal tax rates that people will face as their real incomes rise in the future (the tax code is indexed for inflation, but not for real economic growth). In terms of total receipts collected relative to GDP, those income tax increases are partly offset by declines in Federal excise tax receipts, which are generally not indexed for inflation. Payroll taxes also are projected to decline relative to GDP because the base for these taxes—cash wages and salaries—has shown a tendency to decline relative to total compensation, which again partly offsets the increase in income tax receipts. Even so, the overall share of Federal receipts in GDP is projected to rise above the average of 17 to 19 percent that prevailed from 1960 through the mid-1990s and approaches 22 percent by 2080.

The long-run budget outlook is highly uncertain (see the technical note at the end of this chapter for a discussion of the forecasting assumptions used to make these budget projections). With pessimistic assumptions, the fiscal picture deteriorates even sooner than in the base projection. More optimistic assumptions imply a longer period before the pressures of rising entitlement spending overwhelm the budget. But despite the unavoidable uncertainty, these projections show that under a wide range of reasonable forecasting assumptions, the resources generated by the programs themselves will be insufficient to cover the long-run costs of Social Security and Medicare. The recently passed Medicare Prescription Drug, Improvement, and Modernization Act of 2003, which added a vital new prescription drug benefit to Medicare, will put additional cost pressures on the program. However, this legislation made other important changes to Medicare, including a significant increase in private sector participation and new fiscal safeguards, which may help address Medicare's long-run shortfall. Despite these improvements, Medicare's long-run financial outlook remains uncertain, and it is likely that further reforms will be necessary to sustain both Medicare and Social Security in the future.

Alternative Economic and Technical Assumptions

The quantitative results discussed above are sensitive to changes in underlying economic and technical assumptions. Some of the most important of these alternative economic and technical assumptions and their effects on the budget outlook are discussed below. Each highlights one of the key uncertainties in the outlook. All show that there are mounting deficits under most reasonable projections of the budget.

Table 12–2. LONG-RUN BUDGET PROJECTIONS OF 2005 BUDGET POLICY

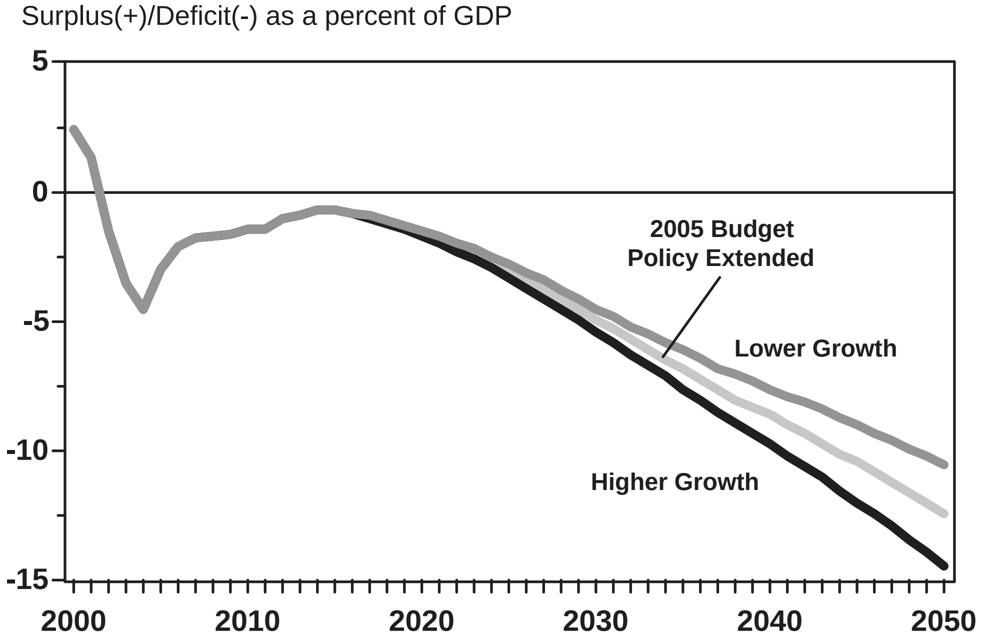
(Percent of GDP)

	2000	2010	2020	2030	2040	2060	2080
Discretionary Spending Grows with GDP:							
Receipts	20.9	17.9	18.6	19.0	19.5	20.6	21.6
Outlays	18.4	19.3	20.3	24.1	28.2	37.7	53.2
Discretionary	6.3	6.2	5.4	5.4	5.4	5.4	5.4
Mandatory	9.8	11.0	13.0	15.9	17.9	20.6	24.6
Social Security	4.2	4.2	5.0	6.0	6.2	6.5	6.8
Medicare	2.0	2.9	3.9	5.9	7.4	9.6	12.5
Medicaid	1.2	1.7	2.1	2.4	2.7	3.3	4.1
Other	2.4	2.3	1.9	1.7	1.5	1.2	1.1
Net Interest	2.3	2.1	1.8	2.7	4.9	11.7	23.2
Surplus or Deficit (–)	2.4	–1.4	–1.7	–5.0	–8.7	–17.2	–31.6
Primary Surplus or Deficit (–)	4.7	0.7	0.1	–2.3	–3.8	–5.5	–8.4
Federal Debt Held by the Public	35.1	39.3	34.0	51.3	92.2	219.3	432.3

1. *Health Spending:* The projections for Medicare over the next 75 years are based on the actuarial projections in the 2003 Medicare Trustees' Report, as adjusted for the effects of the Medicare prescription drug and modernization bill enacted in December 2003. Following the recommendations of its Technical Review Panel, the Medicare trustees assume that over the long-run "age- and gender-adjusted, per-beneficiary spending growth exceeds the growth of per-capita GDP by 1 percentage point per year." This implies that total Medicare spending will rise faster than GDP throughout the projection period.

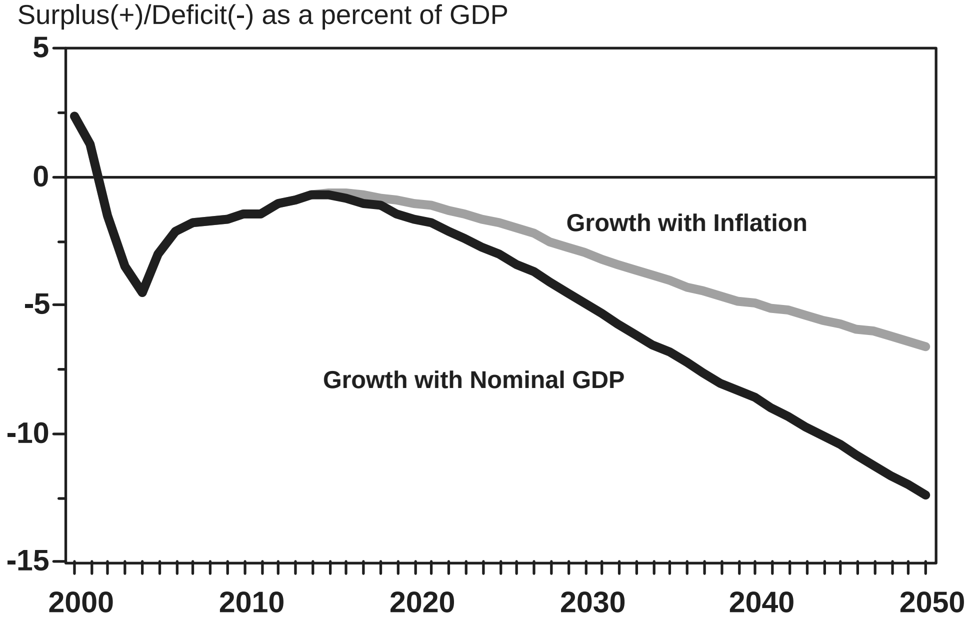
Eventually, the rising trend in health care costs for both Government and the private sector will have to end, but it is hard to know when and how that will happen. "Eventually" could be a long way off. Improved health and increased longevity are highly valued, and society may be willing spend a much larger share of income on them than it has heretofore. Whether society will be willing to devote the large share of resources to health care implied by these projections is an open question. The alternatives highlight the effect of raising the projected growth rate in per capita health care costs by 1/4 percentage point and the effect of lowering it by the same amount.

Chart 12-3. Health Care Cost Alternatives



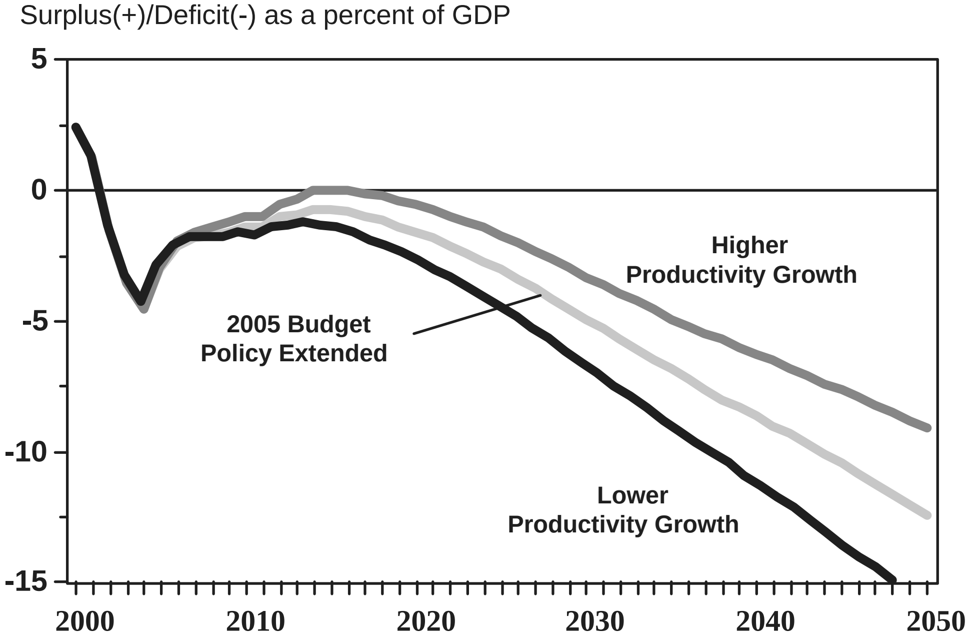
2. *Discretionary Spending:* The assumption used to project discretionary spending is essentially arbitrary, because discretionary spending is determined annually through the legislative process, and no formula can dictate future spending in the absence of legislation. Alternative assumptions have been made for discretionary spending in past budgets. Holding discretionary spending unchanged in real terms is the "current services" assumption used for baseline budget projections when there is no legislative guidance on future spending levels. Extending this assumption over many decades, however, is not necessarily realistic. When the population and economy are expected to grow, the demand for public services is likely to expand, although not necessarily as fast as GDP. The current base projection assumes that discretionary spending keeps pace with the growth in GDP in the long run, so that spending increases in real terms whenever there is real economic growth. An alternative assumption would be that discretionary spending increases only for inflation. In other words, real inflation-adjusted level of discretionary spending holds constant. This alternative moderates the long-run rise in the deficit because the shrinkage in discretionary spending as a share of GDP partially offsets the rise in entitlement outlays.

Chart 12-4. Alternative Discretionary Spending Assumptions



3. *Productivity:* The rate of future productivity growth has an important effect on the long-run budget outlook. It is also highly uncertain. Over the next few decades an increase in productivity growth would reduce the projected budget deficits appreciably. Higher productivity growth adds directly to the growth of the major tax bases, while it has only a delayed effect on outlay growth even assuming that in the long-run discretionary outlays rise with GDP. In the latter half of the 1990s, after two decades of much slower growth, productivity growth increased unexpectedly and it has increased again during the first three years of the new century. The increase in productivity growth is one of the most welcome developments of the last several years. Although the long-run growth rate of productivity is inherently uncertain, it has averaged 2.3 percent since 1948, and the long-run budget projections assume that real GDP per hour will also grow at a 2.3 percent annual rate over most of this century. The alternatives highlight the effect of raising the projected productivity growth rate by 1/4 percentage point and the effect of lowering it by a same amount.

Chart 12-5. Alternative Productivity Assumptions



4. *Population:* The key assumptions for projecting long-run demographic developments concern fertility, immigration, and mortality.

- The demographic projections assume that fertility will average around 1.9 births per woman in the future, just slightly below the replacement rate needed to maintain a constant population—2.1 births.
- The rate of immigration is assumed to average around 900,000 per year in these projections. Higher immigration relieves some of the downward pressure on population from low fertility and allows total population to expand throughout the projection period, although at a much slower rate than has prevailed historically in the United States.
- Mortality is projected to decline; i.e., people are expected to live longer. The average female lifespan is projected to rise from 79.5 years in 2002 to 85.5 years by 2080, and the average male lifespan is projected to increase from 74.2 years in 2002 to 81.6 years by 2080. A technical panel to the Social Security Trustees recently reported that the improvement in longevity might even be greater.

Chart 12-6. Alternative Fertility Assumptions

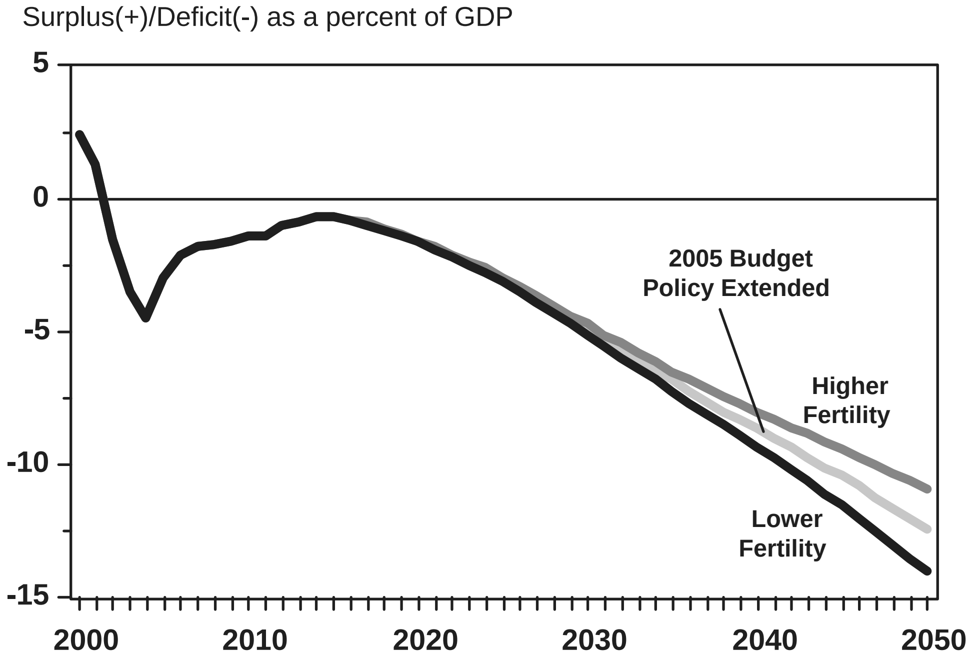


Chart 12-7. Alternative Mortality Assumptions

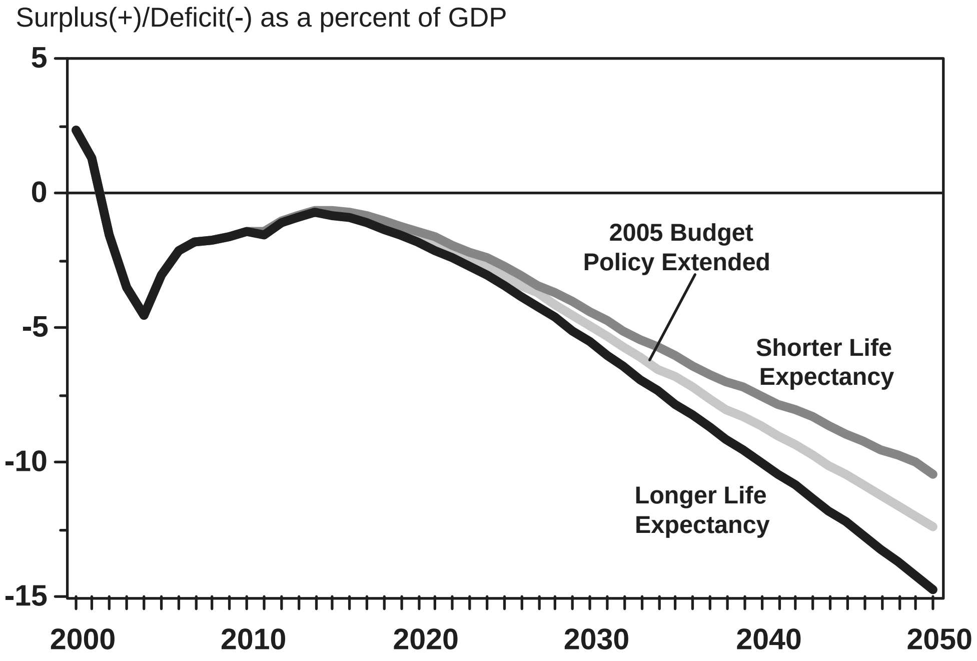
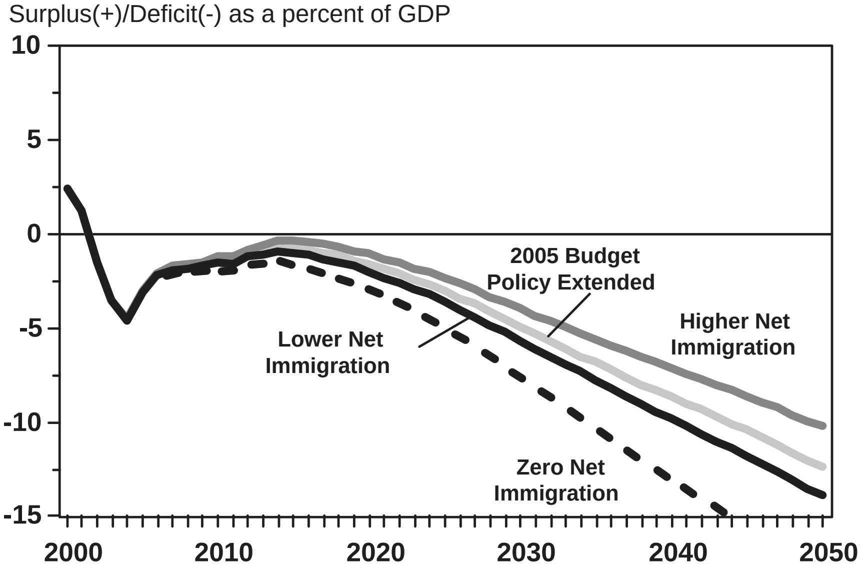


Chart 12-8. Alternative Immigration Assumptions



Actuarial Projections for Social Security and Medicare

Social Security and Medicare are the Government's two largest entitlement programs. Both rely on payroll tax receipts from current workers and employers for at least part of their financing, while the programs' benefits largely go to those who are retired. The importance of these programs for the retirement security of current and future generations makes it essential to understand their long-range financial prospects. Although Social Security and Medicare's Hospital Insurance (HI) program are currently in surplus, actuaries for both programs have calculated that they face long-run deficits. How best to measure the long-run imbalances in Social Security and in the consolidated Medicare program, including Supplementary Medical Insurance (SMI) as well as HI, is a challenging analytical question, but reasonable calculations suggest that each program faces such a huge financial deficiency that it will be very difficult for the Government as a whole to maintain control of the budget without addressing each of these program's financial problems.

Social Security: The Long-Range Challenge

Social Security provides retirement security and disability insurance for tens of millions of Americans through a system that is intended to be self-financing over time. The principle of self-financing is important because it compels corrections in the event that projected benefits consistently exceed dedicated receipts.

While Social Security is running surpluses today, it will begin running cash deficits in about 15 years. Social Security's spending path is unsustainable under current law. The impending retirement of the baby-boom generation, born following World War II, will greatly increase the number of Social Security beneficiaries beginning within ten years. Demographic trends toward lower fertility rates and longer life spans mean that the ratio of retirees to the working population will remain permanently higher. The number of workers available to support each retiree will decline from 3.3 today to 2.2 in 2030 and continue to drift down slowly from there. This means that the Government will not be able to meet current-law benefit obligations at current payroll tax rates.

The future size of Social Security's shortfall cannot be known with any precision, but a gap between Social Security receipts and outlays emerges under a wide range of reasonable forecasting assumptions. Long-range uncertainty underscores the importance of creating a system that is financially stable and self-contained. Otherwise, if the pessimistic assumptions turn out to be more accurate, the demands created by Social Security could compromise the rest of the budget and the Nation's economic health.

The current structure of Social Security leads to substantial generational differences in the average rate of return people can expect from the program. While previous generations have fared extremely well, the average individual born today can expect to receive less than a two percent annual real rate of return on their payroll taxes (including the employer's portion, which most economists believe is borne by labor). Moreover, such estimates in a sense overstate the expected rate of return for future retirees, because they assume no changes in current-law taxes or benefits, even though such changes are needed to meet Social Security's financing shortfall. As an example, a 1995 analysis found that for an average worker born in 2000 a 1.7 percent rate of return would turn into a 1.5 percent rate of return after adjusting revenues to keep the system solvent.

One way to address the issues of uncertainty and declining rates of return, while protecting national savings, would be to allow individuals to invest some of their payroll taxes in personal retirement accounts. The President's Commission to Strengthen Social Security presented various options that would include personal accounts within the Social Security framework.

Medicare: The Long-Range Challenge

Medicare provides health insurance for tens of millions of Americans, including most of the nation's seniors. It is composed of two programs: Hospital Insurance (HI) or Part A, which covers medical expenses relating to hospitalization, and Supplementary Medical Insurance (SMI) or Part B, which pays for physician and outpatient services, and will now also pay for the new prescription drug benefit.

Like social security, HI is self-financing through dedicated taxes. According to the Medicare trustees' most recent report, projected spending for HI under current law will exceed taxes going into the HI trust fund after 2012, and the fund is projected to be depleted by 2026. Looking at the long run, the Medicare actuaries project a 75-year unfunded promise to Medicare's HI trust fund of around $6 trillion. However, this measure tells less than half the story because it does not include the deficiency in Medicare's SMI trust fund. SMI's only source of dedicated revenues is beneficiary premiums, which generally cover about one-quarter of its expenses. SMI's funding structure creates an enormous financing gap for the program, and is the largest contributor to the total Medicare program shortfall of $15.8 trillion (or $15.6 trillion including trust fund assets). (These estimates are as of the 2003 Medicare trustees' report and do not reflect the effects of the recent Medicare prescription drug and reform legislation.)

SMI's financing shortfall is covered by an unlimited tap on general revenues, the ultimate source of which is the Federal taxpayer. The new Medicare prescription drug legislation builds in fiscal safeguards to monitor Medicare's use of general revenues. The trustees are required to analyze Medicare's reliance on these funds, and issue a warning if Medicare's reliance on general revenues is projected to exceed 45 percent of total Medicare expenditures at any point during the following six years. Current projections indicate that Medicare's reliance on general revenues may exceed this threshold as early as 2014. If the trustees issue a warning in two consecutive years, the bill provides special legislative procedures to allow the President and Congress to address the shortfall in advance of financial crises in the Medicare trust funds.

The 75-Year Horizon: In their annual reports and related documents, the Social Security and Medicare trustees typically present calculations of the 75-year actuarial imbalance or deficiency for Social Security and Medicare. The calculation covers current workers and retirees, as well as those projected to join the program within the next 75 years (this is the so-called "open-group" calculation; the "closed-group" covers only current workers and retirees". These estimates measure the present discounted value of each program's future benefits net of future income. They are complementary to the flow projections described in the preceding section.

The present discounted value of the Social Security imbalance was estimated to be about $5 trillion at the beginning of 2003, and the comparable estimate for Medicare was around $16 trillion. (The estimates in Table 12–3 were prepared by the Social Security and Medicare actuaries, and they are based on the intermediate economic and demographic assumptions used for the 2003 trustees' reports. These differ in some respects from the assumptions used for the long-run budget projections described in the preceding section, but the basic message of Table 12–3 would not change if OMB assumptions had been used for the calculations.)

Limiting the calculations to 75 years understates the deficiencies, because the actuarial calculations omit the large deficits that continue to occur beyond the 75th year. The understatement is significant, even though values beyond the 75th year are discounted by a large amount. The current deficiency in Social Security is essentially due to the excess benefits paid to past and current participants compared with their taxes. For current program participants, the present value of expected future benefits exceeds the present value of expected future taxes by about $12 trillion. By contrast, future participants—those who are now under age 15 or not yet born—are projected to pay in present value about $7 trillion more over the next 75 years than they will collect in benefits over that period. In fixing the horizon at 75 years, most of the taxes of these future participants are counted without a full accounting for their expected benefits, much of which will be received beyond the 75th year. For Social Security, the present value of benefits less taxes in the 76th year alone is nearly $0.1 trillion. Altogether, the far distant benefits, estimated in perpetuity, add about $7 trillion to the imbalance, which essentially offsets the expected net contribution from future participants over the next 75 years.

Medicare: A significant portion of Medicare's deficiency is caused by the rapid expected increase in future benefits due to rising health care costs. Some, perhaps most, of the projected increase in relative health care costs reflects improvements in the quality of care, although there is also evidence that medical errors and waste add unnecessarily to health care costs. Even though the projected increases in Medicare spending are likely to contribute to longer life-spans and safer treatments, the financial implications remain the

Table 12–3. ACTUARIAL PRESENT VALUES OVER A 75–YEAR PROJECTION PERIOD

(Discounted Present Value of Expected Benefit Payments in Excess of Future Earmarked Taxes and Premiums as of Jan. 1, 2003, Trillions of Dollars)

	2000	2001	2002	2003
Social Security				
Future benefits less future taxes for those age 15 and over	9.6	10.5	11.2	11.7
Future benefits less taxes for those age 14 and under and those not yet born	–5.8	–6.3	–6.7	–6.8
Net present value for past, present and future participants	**3.8**	**4.2**	**4.6**	**4.9**
Medicare				
Future benefits less future taxes and premiums for those age 15 and over	9.9	12.5	12.9	15.0
Future benefits less taxes and premiums for those age 14 and under and those not yet born	–0.7	0.3	0.4	0.8
Net present value for past, present and future participants	**9.2**	**12.8**	**13.3**	**15.8**
Social Security and Medicare				
Future benefits less future taxes and premiums for those age 15 and over	19.5	23.0	24.1	26.7
Future benefits less taxes and premiums for those age 14 and under and not yet born	–6.5	–6.0	–6.3	–6.0
Net present value for past, present and future participants	**13.0**	**17.0**	**17.8**	**20.7**
Addendum:				
Actuarial deficiency as a percent of the discounted payroll tax base:				
Social Security	–1.89	–1.86	–1.87	–1.92
Medicare HI	–1.21	–1.97	–2.02	–2.40

same. As long as medical costs continue to outpace the growth of GDP and other expenditures, as assumed in these projections, the financial pressure on the budget will mount.

The rapid projected growth of Medicare spending is reflected in the estimates in Table 12–3. For current participants, the difference between the discounted value of benefits and taxes plus premiums is $15 trillion, which is larger than the similar gap for Social Security. For future participants over the next 75 years, Medicare benefits are projected to be roughly equal in magnitude to future taxes and premiums. Unlike Social Security, the discounted value of future taxes does not exceed benefits during this period even though benefits beyond the 75th year are not counted. Extending the calculation beyond the 75th year would add many trillions of dollars in present value to Medicare's actuarial deficiency, just as it would for Social Security. Passage of the Medicare Prescription Drug, Improvement and Modernization Act added to Medicare's actuarial deficiency, but it is uncertain how large the final impact will be given that the legislation increased private sector participation and added new fiscal safeguards which may help address Medicare's financial shortfall. The 2004 Medicare trustees' report will provide actuarial estimates of long-run Medicare income and expenditures that reflect the new law.

General revenues have historically covered about 75 percent of SMI program costs, with the rest being covered by premiums paid by the beneficiaries. In Table 12–3, only the receipts explicitly earmarked for financing these programs have been included. The intragovernmental transfer is not financed by dedicated tax revenues, and the share of general revenues that would have to be devoted to SMI to close the gap increases substantially under current projections. Other Government programs also have a claim on these general revenues, and SMI has no priority in the competition for future funding. From the standpoint of the Government as a whole, only receipts from the public can finance expenditures.

The Trust Funds and the Actuarial Deficiency: The simple fact that a trust fund exists does not mean that the Government necessarily saved the money recorded there. To have saved the Social Security and HI trust fund surpluses as they accumulated would have required the Government to set aside the surpluses reducing the unified budget deficit dollar for dollar with the change in the trust fund balance (or adding dollar for dollar to a unified budget surplus). It is an open question whether this happened or not. The large unified budget deficits that prevailed during most of the time when the trust funds were increasing suggests that the Government did not do this, although to know this for sure it would be necessary to know what the unified deficit would have been in the absence of those trust fund surpluses, and that is not really knowable.

The assets in the trust funds are special purpose financial instruments issued by the Treasury Department. At the time Social Security or Medicare redeems these instruments to pay future benefits not covered by future income, the Treasury will have to turn to the public capital markets to raise the funds to finance the benefits, just as if the trust funds had never existed. From the standpoint of overall Government finances, the trust funds do not reduce the future burden of financing Social Security or Medicare benefits.

In any case, the trust funds remain small in size compared with the programs' future obligations and well short of what would be needed to pre-fund future benefits as indicated by the programs' actuarial deficiencies. Historically, Social Security and Medicare's HI program were financed mostly on a pay-as-you-go basis, whereby workers' payroll taxes were immediately used to pay retiree benefits. For the most part, workers' taxes have not been used to pre-fund their own future benefits, and taxes were not set at a level sufficient to pre-fund future benefits even had they been saved.

The Importance of Long-Run Measures in Evaluating Policy Changes: Consider a proposed policy change in which payroll taxes paid by younger workers were reduced by $100 this year while the expected present value of these workers' future retirement benefits were also reduced by $100. The present discounted value of future benefit payments would decrease by the same amount as the reduction in revenue. On a cash flow basis, however, the lost revenue occurs now, while the decrease in future outlays is in the distant future beyond the budget window, and the Federal Government must increase its borrowing to make up for the lost revenue in the meantime. If policymakers only focus on the Government's near-term borrowing needs, a reform such as this would appear to worsen the Government's finances, whereas the policy actually has a neutral impact. Extending the forecast horizon to 75 years, as in this chapter, can help to avoid such a false impression, although any fixed horizon, even 75 years, can give rise to a distorted comparison if budget effects continue past that point.

Now suppose that future outlays were instead reduced by a little more than $100 in present value. In this case, the actuarial deficiency would actually *decline,* even though the Government's borrowing needs would again increase. Focusing on the Government's near-term borrowing alone, therefore, can lead to a bias against policies that could improve the Federal Government's overall fiscal condition. Taking a longer view of policy changes and considering measures of the Government's fiscal condition other than the unified budget surplus or deficit can correct for such mistakes.

PART IV—NATIONAL WEALTH AND WELFARE

Unlike a private corporation, the Federal Government routinely invests in ways that do not add directly to its assets. For example, Federal grants are frequently used to fund capital projects by State or local governments for highways and other purposes. Such investments are valuable to the public, which pays for them with its taxes, but they are not owned by the Federal Government and would not show up on a conventional balance sheet for the Federal Government. It is true, of course, that by encouraging economic growth in the private sector, the Government augments future Federal tax receipts. However, the fraction of their returns that comes back to the Government in higher taxes is far less than what a private investor would require before undertaking a similar investment.

The Federal Government also invests in education and research and development (R&D). These outlays contribute to future productivity and are analogous to an investment in physical capital. Indeed, economists have computed stocks of human and knowledge capital to reflect the accumulation of such investments. Nonetheless, such hypothetical capital stocks are obviously not owned by the Federal Government, nor would they appear on a typical balance sheet as a Government asset, even though these investments may contribute to future tax receipts.

To show the importance of these kinds of issues, Table 12–4 presents a national balance sheet. It includes estimates of national wealth classified into three categories: physical assets, education capital, and R&D capital. The Federal Government has made contributions to each of these categories of capital, and these contributions are shown separately in the table. At the same time, the private wealth shown in Table 12–4 can be drawn on by Government to finance future public activities. The Nation's wealth sets the ultimate limit on the resources available to the Government. Data in this table are especially uncertain, because of the strong assumptions needed to prepare the estimates.

The conclusion of the table is that Federal investments are responsible for about 7 percent of total national wealth including education and research and development. This may seem like a small fraction, but it represents a large volume of capital—$6.0 trillion. The Federal contribution is down from near 9 percent in the mid-1980s and from around 11 percent in 1960. Much of this reflects the shrinking size of defense capital stocks, which have declined from around 12 percent of GDP in the mid-1980s to 6 percent in 2003.

Physical Assets: The physical assets in the table include stocks of plant and equipment, office buildings, residential structures, land, and the Government's physical assets such as military hardware and highways. Automobiles and consumer appliances are also included in this category. The total amount of such capital is vast, around $46 trillion in 2003, consisting of $39 trillion in private physical capital and $7 trillion in public physical capital (including capital funded by State and local governments); by comparison, GDP was about $11 trillion in 2003. The Federal Government's contribution to this stock of capital includes its own physical assets of $2.4 trillion plus $1.1 trillion in accumulated grants to State and local governments for capital projects. The Federal Government has financed about one-fourth of the physical capital held by other levels of government.

Education Capital: Economists have developed the concept of human capital to reflect the notion that individuals and society invest in people as well as in physical assets. Investment in education is a good example of how human capital is accumulated.

This table includes an estimate of the stock of capital represented by the Nation's investment in formal education and training. The estimate is based on the cost of replacing the years of schooling embodied in the U.S.

Table 12–4. NATIONAL WEALTH

(As of the end of the fiscal year, in trillions of 2003 dollars)

	1960	1965	1970	1975	1980	1985	1990	1995	2000	2001	2002	2003
ASSETS												
Publicly Owned Physical Assets:												
Structures and Equipment	2.0	2.3	2.9	3.5	3.8	4.0	4.4	4.8	5.5	5.6	5.6	5.6
Federally Owned or Financed	1.2	1.3	1.4	1.6	1.6	1.9	2.0	2.1	2.1	2.1	2.2	2.2
Federally Owned	1.0	1.0	1.1	1.0	1.0	1.1	1.1	1.1	1.0	1.0	1.0	1.0
Grants to State and Local Governments	0.2	0.2	0.3	0.5	0.6	0.8	0.8	0.9	1.1	1.1	1.2	1.2
Funded by State and Local Governments	0.9	1.1	1.5	2.0	2.2	2.1	2.4	2.7	3.4	3.5	3.4	3.3
Other Federal Assets	0.7	0.7	0.7	0.8	1.3	1.4	1.1	0.9	1.2	1.2	1.2	1.4
Subtotal	2.8	3.0	3.5	4.4	5.1	5.4	5.5	5.6	6.7	6.8	6.8	6.9
Privately Owned Physical Assets:												
Reproducible Assets	7.1	8.2	10.0	12.8	16.7	17.6	20.0	21.9	26.5	27.0	27.9	28.7
Residential Structures	2.7	3.2	3.8	4.9	6.7	6.9	7.8	8.8	10.9	11.3	11.8	12.4
Nonresidential Plant and Equipment	2.9	3.3	4.1	5.4	6.9	7.6	8.4	9.2	11.1	11.3	11.6	11.8
Inventories	0.6	0.7	0.9	1.1	1.4	1.3	1.4	1.4	1.6	1.5	1.5	1.5
Consumer Durables	0.9	1.0	1.3	1.5	1.8	1.9	2.3	2.5	2.8	2.9	3.0	3.1
Land	2.1	2.5	2.9	3.7	5.7	6.5	6.7	5.2	8.0	8.4	9.7	10.2
Subtotal	9.2	10.7	12.9	16.5	22.4	24.1	26.6	27.1	34.5	35.4	37.5	38.9
Education Capital:												
Federally Financed	0.1	0.1	0.2	0.3	0.5	0.6	0.8	0.9	1.2	1.2	1.3	1.4
Financed from Other Sources	6.2	8.0	10.8	13.3	17.4	20.8	26.9	30.1	39.1	40.7	42.2	44.0
Subtotal	6.3	8.1	11.0	13.6	17.8	21.4	27.7	31.0	40.3	41.9	43.5	45.4
Research and Development Capital:												
Federally Financed R&D	0.2	0.3	0.5	0.6	0.6	0.7	0.8	0.9	1.0	1.0	1.1	1.1
R&D Financed from Other Sources	0.1	0.2	0.3	0.4	0.5	0.7	0.9	1.1	1.5	1.6	1.7	1.7
Subtotal	0.3	0.6	0.8	0.9	1.1	1.4	1.7	2.1	2.5	2.6	2.7	2.9
Total Assets	**18.6**	**22.3**	**28.2**	**35.5**	**46.4**	**52.2**	**61.5**	**65.8**	**84.0**	**86.8**	**90.6**	**94.1**
Net Claims of Foreigners on U.S. (+)	–0.1	–0.2	–0.2	–0.1	–0.4	0.0	0.9	1.5	2.8	2.7	3.1	4.2
Net Wealth	**18.7**	**22.5**	**28.4**	**35.6**	**46.7**	**52.2**	**60.6**	**64.3**	**81.1**	**84.1**	**87.5**	**89.9**
ADDENDA:												
Per Capita Wealth (thousands of 2003 dollars)	103.6	115.9	138.5	165.1	204.8	218.6	242.0	240.8	286.9	294.0	302.7	307.8
Ratio of Wealth to GDP (in percent)	704.4	716.4	695.7	696.3	679.2	674.0	663.6	683.5	688.9	711.4	714.4	718.2
Total Federally Funded Capital (trils 2003 dollars)	2.1	2.4	2.8	3.3	3.9	4.5	4.7	4.8	5.5	5.6	5.8	6.1
Percent of National Wealth	11.5	10.7	9.9	9.3	8.4	8.7	7.8	7.4	6.8	6.7	6.6	6.8

population aged 16 and over; in other words, the goal is to measure how much it would cost to reeducate the U.S. workforce at today's prices (rather than at its original cost). This is more meaningful economically than the historical cost, and is comparable to the measures of physical capital presented earlier.

Although this is a relatively crude measure, it does provide a rough order of magnitude for the current value of the investment in education. According to this measure, the stock of education capital amounted to $45 trillion in 2003, of which about 3 percent was financed by the Federal Government. It was nearly equal to the total value of the Nation's stock of physical capital. The main investors in education capital have been State and local governments, parents, and students themselves (who forgo earning opportunities in order to acquire education).

Even broader concepts of human capital have been proposed. Not all useful training occurs in a schoolroom or in formal training programs at work. Much informal learning occurs within families or on the job, but measuring its value is very difficult. Labor compensation, however, amounts to about two-thirds of national income with the other third attributed to capital and thinking of this labor income as the product of human capital suggests that the total value of human capital might be two times the estimated value of physical capital assuming human capital had earned a similar rate of return to other forms of capital. Thus, the estimates offered here are in a sense conservative, because they reflect only the costs of acquiring formal education and training, which is why they are referred to as education capital rather than human capital. They constitute the part of human capital that can be attributed to formal education and training.

Research and Development Capital: Research and Development can also be thought of as an investment, because R&D represents a current expenditure that is made in the expectation of earning a future return. After adjusting for depreciation, the flow of R&D investment can be added up to provide an estimate of the current R&D stock.[3] That stock is estimated to have been $2.9 trillion in 2003. Although this represents a large amount of research, it is a relatively small portion

[3] R&D depreciates in the sense that the economic value of applied research and development tends to decline with the passage of time, as still newer ideas move the technological frontier.

of total National wealth. Of this stock, 38 percent was funded by the Federal Government.

Liabilities: When considering how much the United States owes as a Nation, the debts that Americans owe to one another cancel out. When the debts of one American are the assets of another American, these debts are not a net liability of the Nation as a whole. Table 12–4 is intended to show National totals only. Total debt is important even though it does not appear in Table 12–4. The amount of debt owed by Americans to other Americans can exert both positive and negative effects on the economy. Americans' willingness and ability to borrow helped fuel the expansion of the 1990s, and continues to support consumption in the current recovery. On the other hand, bad debts, which are not collectible, can cause serious problems for the banking system.

The only debts that do appear in Table 12–4 are the debts Americans owe to foreigners. America's foreign debt has been increasing rapidly in recent years, because of the rising imbalance in the U.S. current account. Although the current account deficit has been at record levels recently, the size of this debt remains small compared with the total stock of U.S. assets. It amounted to 4.5 percent of total assets in 2002.

Federal debt does not appear explicitly in Table 12–4 because most of it consists of claims held by Americans; only that portion of the Federal debt which is held by foreigners is included along with the other debts to foreigners. Comparing the Federal Government's net liabilities with total national wealth does, however, provide another indication of the relative magnitude of the imbalance in the Government's accounts. Currently, Federal net liabilities, as reported in Table 12–1, amount to 5.6 percent of net U.S. wealth as shown in Table 12–4. Prospectively, however, Federal liabilities are a much larger share of national wealth, as shown by the long-run projections in Part III.

Trends in National Wealth

The net stock of wealth in the United States at the end of FY 2003 was about $90 trillion, about eight times the level of GDP. Since 1961, it has increased in real terms at an average annual rate of 3.7 percent per year. It grew very rapidly from 1960 to 1973, at an average annual rate of 4.5 percent per year, slightly faster than real GDP grew over the same period. Between 1973 and 1995 growth slowed, as real net wealth grew at an average rate of just 3.1 percent per year, which paralleled the slowdown in real GDP over this period. Since 1995 growth has picked up for both net wealth and real GDP, with wealth growing at an average rate of 4.3 percent since 1995. This is the same period in which productivity growth accelerated following a similar slowdown from 1973 to 1995.

The net stock of private nonresidential plant and equipment accounts for about 30 percent of privately owned physical capital. It grew 3.3 percent per year on average from 1960 to 2003. It grew especially rapidly from 1960 to 1973, at an average rate of 3.9 percent per year. Since 1973 it has grown more slowly, averaging around 3.0 percent per year. Unlike most other categories of wealth accumulation, there was very little acceleration in the growth of plant and equipment over the last eight years compared with 1973–1995. Private plant and equipment grew 3.0 percent per year on average between 1973 and 1995 and just 3.1 percent per year from 1995 through 2003. Higher than average growth in the investment boom of the late 1990s has been offset by less rapid growth since then. Meanwhile, privately owned residential structures, consumer durables and land have all grown more rapidly in real value since 1995 than from 1973 to 1995.

The accumulation of education capital has averaged 4.7 percent per year since 1960. It also slowed down between 1973 and 1995, and has grown somewhat more rapidly since then. It grew at an average rate of 5.8 percent per year in the 1960s, about 1.9 percentage point faster than the average rate of growth in private physical capital during the same period. Since 1995, education capital has grown at a 4.9 percent annual rate. This reflects both the extra resources devoted to schooling in this period, and the fact that such resources were increasing in economic value. R&D stocks have also grown at about 4.2 percent per year since 1995.

Other Federal Influences on Economic Growth

Federal investment decisions, as reflected in Table 12–4, obviously are important, but the Federal Government also contributes to wealth in ways that cannot be easily captured in a formal presentation. The Federal Reserve's monetary policy affects the rate and direction of capital formation in the short run, and Federal regulatory and tax policies also affect how capital is invested, as do the Federal Government's policies on credit assistance and insurance.

Social Indicators

There are certain broad responsibilities that are unique to the Federal Government. Especially important are fostering healthy economic conditions including sound economic growth, promoting health and social welfare, and protecting the environment. Table 12–5 offers a rough cut of information that can be useful in assessing how well the Federal Government has been doing in promoting these general objectives.

The indicators shown in Table 12–5 are only a subset drawn from the vast array of available data on conditions in the United States. In choosing indicators for this table, priority was given to measures that were consistently available over an extended period. Such indicators make it easier to draw valid comparisons and evaluate trends. In some cases, however, this meant choosing indicators with significant limitations.

The individual measures in this table are influenced to varying degrees by many Government policies and programs, as well as by external factors beyond the Government's control. They do not measure the outcomes of Government policies, because they generally

Table 12–5. ECONOMIC AND SOCIAL INDICATORS

General categories	Calendar Years	1960	1965	1970	1975	1980	1985	1990	1995	2000	2001	2002	2003
Economic:													
Living Standards	Real GDP per person (2000 dollars)	13,840	16,420	18,392	19,961	22,666	25,382	28,429	30,128	34,753	34,550	34,934	35,648
	average annual percent change (5–year trend)	1.7	3.5	2.3	1.7	2.6	2.3	2.3	1.2	2.9	2.3	1.8	1.7
	Median Income:	....	....	....	....	....	....	....	....	....	....	....	....
	All Households (2002 dollars)	N/A	N/A	35,030	34,763	36,608	37,648	39,949	39,931	43,848	42,900	42,409	N/A
	Married Couple Families (2001 dollars) [1]	29,746	34,620	41,516	43,113	47,086	48,798	52,394	54,284	60,748	60,335	N/A	N/A
	Female Householder, Husband Absent (2001 dollars) [1] ...	15,032	16,831	20,107	19,847	21,177	21,434	22,237	22,713	26,434	25,745	N/A	N/A
	Income Share of Lower 60% of All Households	31.8	32.2	32.3	32.0	31.5	30.0	29.4	28.0	27.3	26.8	27.1	N/A
	Poverty Rate (%) [2]	22.2	17.3	12.6	12.3	13.0	14.0	13.5	13.8	11.3	11.7	12.1	N/A
Economic Security	Civilian Unemployment (%)	5.5	4.5	4.9	8.5	7.1	7.2	5.5	5.6	4.0	4.8	5.8	6.0
	CPI-U (% Change)	1.7	1.6	5.8	9.1	13.5	3.5	5.4	2.8	3.4	2.8	1.6	2.3
Employment	Increase in Total Payroll Employment Previous 12 Months.	–0.4	2.9	–0.4	0.4	0.3	2.5	0.3	2.2	1.9	–1.8	–0.5	–0.1
	Managerial or Professional Jobs (% of civilian employment).	N/A	N/A	N/A	N/A	N/A	27.3	29.2	32.0	33.8	34.4	34.6	34.8
Wealth Creation	Net National Saving Rate (% of GDP) [3]	10.2	12.1	8.2	6.6	7.5	6.1	4.6	4.7	5.9	3.3	1.6	0.7
Innovation	Patents Issued to U.S. Residents (thousands) [4]	42.3	54.1	50.6	51.5	41.7	45.1	56.1	68.2	103.6	105.5	99.6	N/A
	Multifactor Productivity (average 5 year percent change)	0.9	2.9	0.8	1.1	0.8	0.5	0.5	0.6	1.1	0.7	N/A	N/A
	Nonfarm Output per Hour (average 5 year percent change).	1.8	3.5	2.0	2.3	1.2	1.7	1.4	1.5	2.5	2.4	3.0	3.4
Environment:													
Air Quality	Nitrogen Oxide Emissions (thousand short tons)	18,163	21,296	26,883	26,377	27,079	25,757	25,530	24,956	23,199	22,349	N/A	N/A
	Sulfur Dioxide Emissions (thousand short tons)	22,268	26,799	31,218	28,043	25,925	23,307	23,078	18,619	16,317	15,790	N/A	N/A
	Lead Emissions (thousand short tons)	N/A	N/A	221	160	74	23	5	4	4	4	N/A	N/A
Water Quality	Population Served by Secondary Treatment or Better (mils).	N/A	N/A	N/A	N/A	N/A	140.3	162.3	173.8	201.4	N/A	N/A	N/A
Social:													
Families	Children Living with Mother Only (% of all children)	9.2	10.2	11.6	16.4	18.6	20.2	21.6	24.0	22.3	22.7	23.2	N/A
Safe Communities	Violent Crime Rate (per 100,000 population) [5]	160.0	199.0	364.0	482.0	597.0	558.1	729.6	684.5	506.5	504.5	494.6	483.8
	Murder Rate (per 100,000 population) [5]	5.1	5.1	7.8	9.6	10.2	8.0	9.4	8.2	5.5	5.6	5.6	5.6
	Murders (per 100,000 Persons Age 14 to 17)	N/A	N/A	N/A	4.5	5.9	4.9	9.8	11.0	4.7	N/A	N/A	N/A
Health	Infant Mortality (per 1000 Live Births)	26.0	24.7	20.0	16.1	12.6	10.6	9.2	7.6	6.7	6.8	6.9	6.7
	Low Birthweight [<2,500 gms] Babies (%)	7.7	8.3	7.9	7.4	6.8	6.8	7.0	7.3	7.6	7.7	7.8	N/A
	Life Expectancy at birth (years)	69.7	70.2	70.8	72.6	73.7	74.7	75.4	75.8	77.0	77.2	N/A	N/A
	Cigarette Smokers (% population 18 and older) [6]	N/A	41.9	39.2	36.3	33.0	29.9	25.3	24.6	23.1	22.6	22.3	21.6
Learning	High School Graduates (% of population 25 and older) ..	44.6	49.0	55.2	62.5	68.6	73.9	77.6	81.7	84.1	84.3	N/A	N/A
	College Graduates (% of population 25 and older)	8.4	9.4	11.0	13.9	17.0	19.4	21.3	23.0	25.6	26.1	N/A	N/A
Participation	Individual Charitable Giving per Capita (2000 dollars)	240	288	345	367	400	411	456	432	575	585	573	N/A
	–by presidential election year)	1960	1964	1968	1972	1976	1980	1984	1988	1992	1996	2000	
	Voting for President (% eligible population)	62.8	61.9	60.9	55.2	53.5	52.8	53.3	50.3	55.1	49.0	51.2	

[1] Median income for married couple and female householder families not updated yet for 2002.

[2] The poverty rate does not reflect noncash government transfers such as Medicaid or food stamps.

[3] Does not reflect December 2003 revisions to National Income and Product Accounts, which are not yet complete for national saving. 2003 through Q3 only.

[4] Preliminary data for 2002.

[5] Not all crimes are reported, and the fraction that go unreported may have varied over time, 2003 data are preliminary for the first half of the year.

[6] Smoking data for 2003 through June.

do not show the direct results of Government activities, but they do provide a quantitative measure of the progress or lack of progress in reaching some of the ultimate values that Government policy is intended to promote.

Such a table can serve two functions. First, it highlights areas where the Federal Government might need to modify its current practices or consider new approaches. Where there are clear signs of deteriorating conditions, corrective action might be appropriate. Second, the table provides a context for evaluating other data on Government activities. For example, Government actions that weaken its own financial position may be appropriate when they promote a broader social objective. The Government cannot avoid making such trade-offs because of its size and the broad ranging effects of its actions. Monitoring these effects and incorporating them in the Government's policy making is a major challenge.

It is worth noting that, in recent years, many of the trends in these indicators turned around. The improvement in economic conditions has been widely noted, and there have also been some significant social improvements. Perhaps, most notable has been the turnaround in the crime rate. Since reaching a peak in the early 1990s, the violent crime rate has fallen by a third. The turnaround has been especially dramatic in the murder rate, which was lower in 2000 than at any time since the 1960s. The 2001 recession has had an effect on some of these indicators. Unemployment has risen and real GDP growth has declined. But as the economy recovers much of the improvement shown in Table 12–5 is likely to be preserved and extended.

TECHNICAL NOTE: SOURCES OF DATA AND METHOD OF ESTIMATING

Long-Range Budget Projections

The long-range budget projections are based on long-range demographic and economic assumptions. A simplified model of the Federal budget, developed at OMB, computes the budgetary implications of these assumptions.

Demographic and Economic Assumptions: Through 2014, the assumptions are identical to those used for the budget. These budget assumptions reflect the President's policy proposals. The economic assumptions are extended beyond this point by holding constant inflation, interest rates, and unemployment at the levels assumed in the final year of the budget forecast. Population growth and labor force growth are extended using the intermediate assumptions from the 2003 Social Security trustees' report. The projected rate of growth for real GDP is built up from the labor force assumptions and an assumed rate of productivity growth. Productivity growth is held constant at the average rate of growth implied by the budget's economic assumptions.

- CPI inflation holds stable at 2.5 percent per year; the unemployment rate is constant at 5.1 percent; and the yield on 10-year Treasury notes is steady at 5.8 percent, which are the final values at the end of the budget forecast for each of these variables.
- Real GDP per hour grows at the same average rate as in the Administration's medium-term projections—2.3 percent per year—through 2080.
- Consistent with the demographic assumptions in the trustees' reports, U.S. population growth slows from around 1 percent per year to about half that rate by 2030, and even slower rates of growth beyond that point. Population growth reaches 0.3 percent per year at the end of the projection period in 2080 and it is still slowing.
- Real GDP growth declines over time with the expected slowdown in population growth which feeds through to the labor force. An aging population also contributes less work effort, and this is also reflected in the projections. Historically, real GDP has grown at an average yearly rate of 3.4 percent. In these projections, real GDP growth declines to 2.6 percent by 2020, and averages that rate for the next 60 years.

The economic and demographic projections described above are set by assumption and do not automatically change in response to changes in the budget outlook. This is unrealistic, but it simplifies comparisons of alternative policies.

Budget Projections: For the period through 2014, receipts and outlays follow the budget's policy projections. Beyond the budget horizon, receipts are projected using simple rules of thumb linking income taxes, payroll taxes, excise taxes, and other receipts to projected tax bases derived from the economic projections. Discretionary outlays grow at the rate of growth in nominal GDP. Social Security is projected by the Social Security actuaries using these long-range assumptions. Medicare benefits are projected based on the estimates in the 2003 Medicare trustees' report, adjusted for differences in the assumed growth rate in GDP per capita and for the effects of the Medicare Prescription Drug, Improvement, and Modernization Act of 2003. Federal pensions are derived from the most recent actuarial forecasts available at the time the budget is prepared, repriced using Administration inflation and wage growth assumptions. Medicaid outlays are based on the economic and demographic projections in the model. Other entitlement programs are projected based on rules of thumb linking program spending to elements of the economic and demographic projections such as the poverty rate.

Federally Owned Assets and Liabilities

Financial Assets: The source of data is the Federal Reserve Board's Flow-of-Funds Accounts.

Fixed Reproducible Capital: Estimates were developed from the OMB historical data base for physical capital outlays and software purchases. The data base extends back to 1940 and was supplemented by data from other selected sources for 1915–1939. The source data are in current dollars. To estimate investment flows in constant dollars, the nominal investment series was deflated using chained price indexes for Federal investment from the National Income and Product Accounts. The resulting capital stocks were aggregated into nine categories and depreciated using geometric rates roughly following those used by the Bureau of Economic Analysis in its estimates of physical capital stocks.

Fixed Nonreproducible Capital: Historical estimates for 1960–1985 were based on estimates in Michael J. Boskin, Marc S. Robinson, and Alan M. Huber, "Government Saving, Capital Formation and Wealth in the United States, 1947–1985," published in *The Measurement of Saving, Investment, and Wealth,* edited by Robert E. Lipsey and Helen Stone Tice (The University of Chicago Press, 1989).

Estimates were updated using changes in the value of private land from the Flow-of-Funds Balance Sheets and from the Agriculture Department for farm land; the value of Federal oil deposits was extrapolated using the Producer Price Index for Crude Energy Materials.

Debt Held by the Public: Treasury data.

Insurance and Guarantee Liabilities: Sources of data are the OMB Pension Guarantee Model and OMB estimates based on program data. Historical data on liabilities for deposit insurance were also drawn from CBO's study, The Economic Effects of the Savings and Loan Crisis, issued January 1992.

Pension and Post-Employment Health Liabilities: For 1979–2001, the estimates are the actuarial accrued liabilities as reported in the annual reports for the Civil Service Retirement System, the Federal Employees Retirement System, and the Military Retirement System (adjusted for inflation). Estimates for the years before 1979 are extrapolations. The estimate for 2002 is a projection. The health insurance liability was estimated by the program actuaries for 1997–2001, and extrapolated back for earlier years. Veterans disability compensation was taken from the Financial Report of the United States Government (and the Consolidated Financial Statement for some earlier years). Prior to 1976, the values were extrapolated. For 2003, the estimates from the Department of Veterans Affairs' 2003 Performance and Accountability Report.

Other Liabilities: The source of data for trade payables and miscellaneous liabilities is the Federal Reserve's Flow-of-Funds Accounts. The Financial Report of the United States Government was the source for benefits due and payable.

National Balance Sheet

Publicly Owned Physical Assets: Basic sources of data for the Federally owned stocks of capital are the Federal investment flows described in Chapter 6. Federal grants for State and local government capital are added, together with adjustments for inflation and depreciation in the same way as described above for direct Federal investment. Data for total State and local government capital come from the revised capital stock data prepared by the Bureau of Economic Analysis extrapolated for 2002–03.

Privately Owned Physical Assets: Data are from the Flow-of-Funds national balance sheets and from the private net capital stock estimates prepared by the Bureau of Economic Analysis extrapolated for 2002–03 using investment data from the National Income and Product Accounts.

Education Capital: The stock of education capital is computed by valuing the cost of replacing the total years of education embodied in the U.S. population 16 years of age and older at the current cost of providing schooling. The estimated cost includes both direct expenditures in the private and public sectors and an estimate of students' forgone earnings, i.e., it reflects the opportunity cost of education. Estimates of students' forgone earnings are based on the year-round, full-time earnings of 18–24 year olds with selected educational attainment levels. These year-round earnings are reduced by 25 percent because students are usually out of school three months of the year. For high school students, these adjusted earnings are further reduced by the unemployment rate for 16–17 year olds; for college students, by the unemployment rate for 20–24 year olds. Yearly earnings by age and educational attainment are from Money Income in the United States, series P60, published by the Bureau of the Census.

For this presentation, Federal investment in education capital is a portion of the Federal outlays included in the conduct of education and training. This portion includes direct Federal outlays and grants for elementary, secondary, and vocational education and for higher education. The data exclude Federal outlays for physical capital at educational institutions because these outlays are classified elsewhere as investment in physical capital. The data also exclude outlays under the GI Bill; outlays for graduate and post-graduate education spending in HHS, Defense and Agriculture; and most outlays for vocational training. The Federal share of the total education stock in each year is estimated by averaging the prior years' shares of Federal education outlays in total education costs.

Data on investment in education financed from other sources come from educational institution reports on the sources of their funds, published in U.S. Department of Education, Digest of Education Statistics. Nominal expenditures were deflated by the implicit price deflator for GDP to convert them to constant dollar values. Education capital is assumed not to depreciate, but to be retired when a person dies. An education capital stock computed using this method with different source data can be found in Walter McMahon, "Relative Returns to Human and Physical Capital in the U.S. and Efficient Investment Strategies," *Economics of Education Review,* Vol. 10, No. 4, 1991. The method is described in detail in Walter McMahon, *Investment in Higher Education,* Lexington Books, 1974.

Research and Development Capital: The stock of R&D capital financed by the Federal Government was developed from a data base that measures the conduct of R&D. The data exclude Federal outlays for physical capital used in R&D because such outlays are classified elsewhere as investment in federally financed physical capital. Nominal outlays were deflated using the GDP deflator to convert them to constant dollar values.

Federally funded capital stock estimates were prepared using the perpetual inventory method in which annual investment flows are cumulated to arrive at a capital stock. This stock was adjusted for depreciation by assuming an annual rate of depreciation of 10 percent on the estimated stock of applied research and development. Basic research is assumed not to depreciate. These are the same assumptions used in a study published by the Bureau of Labor Statistics estimating the R&D stocks financed by private industry U.S. Department of Labor, Bureau of Labor Statistics, *The Impact of Research and Development on Productivity Growth,* Bulletin 2331, September 1989. Chapter 6 of this volume contains additional details on the estimates of the total federally financed R&D stock, as well as its national defense and nondefense components.

A similar method was used to estimate the stock of R&D capital financed from sources other than the Federal Government. The component financed by universities, colleges, and other nonprofit organizations is estimated based on data from the National Science Foundation, Surveys of Science Resources. The industry-financed R&D stock component is estimated from that source and from the U.S. Department of Labor, *The Impact of Research and Development on Productivity Growth,* Bulletin 2331, September 1989.

Experimental estimates of R&D capital stocks have been prepared by BEA. The results are described in "A Satellite Account for Research and Development," *Survey of Current Business,* November 1994. These BEA estimates are lower than those presented here primarily because BEA assumes that the stock of basic research depreciates, while the estimates in Table 12–5 assume that basic research does not depreciate. BEA also assumes a slightly higher rate of depreciation for applied research and development, 11 percent, compared with the 10 percent rate used here.

Sources of Data and Assumptions for Estimating Social Indicators

The main sources for the data in this table are the Government statistical agencies. The data are all publicly available, and can be found in such general sources as the annual *Economic Report of the President* and the *Statistical Abstract of the United States,* or from agencies' web sites.

13. NATIONAL INCOME AND PRODUCT ACCOUNTS

The National Income and Product Accounts (NIPAs) are an integrated set of measures of aggregate U.S. economic activity that are prepared by the Department of Commerce. Because the NIPAs include Federal transactions and are widely used in economic analysis, it is important to show the NIPAs' distinctive presentation of Federal transactions and contrast it with that of the budget.

One of the main purposes of the NIPAs is to measure the Nation's total production of goods and services, known as gross domestic product (GDP), and the incomes generated in its production. GDP is a measure of the Nation's final output, which excludes intermediate product to avoid double counting. Both government consumption expenditures and government gross investment—State and local as well as Federal—are included in GDP as part of final output, together with personal consumption expenditures, gross private domestic investment, and net exports of goods and services (exports minus imports).

Other Government expenditures—social benefits, grants to State and local governments, subsidies, and interest payments—are not purchases of final output and as such are not included in GDP; however, these transactions are recorded in the NIPA Government current receipts and current expenditure account, together with Government consumption expenditures (which includes depreciation on Government gross investment).

Federal transactions are included in the NIPAs as part of the government sector. [1] The Federal subsector is designed to measure certain important economic effects of Federal transactions in a way that is consistent with the conceptual structure of the entire set of integrated accounts. The NIPA Federal subsector is not itself a budget, because it is not a financial plan for proposing, determining, and controlling the fiscal activities of the Government. Also, it covers current transactions only, whereas the budget includes transactions that the NIPA current account omits from its current receipts and current expenditure totals as "capital transfers." NIPA concepts also differ in many other ways from budget concepts, and therefore the NIPA presentation of Federal finances is significantly different from that of the budget.

Differences Between the NIPAs and the Budget

Federal transactions in the NIPAs are measured according to NIPA accounting concepts in order to be compatible with the purposes of the NIPAs and other transactions recorded in the NIPAs. As a result they differ from the budget in netting, timing, and coverage. These differences cause current receipts and expenditures in the NIPAs to differ from total receipts and outlays in the budget, albeit by relatively small amounts. [2] Differences in timing and coverage also cause the NIPA net Federal Government saving to differ from the budget surplus or deficit. Netting differences have equal effects on receipts and expenditures and thus have no effect on net Government saving. Besides these differences, the NIPAs combine transactions into different categories from those used in the budget.

December 2003 NIPA Revisions.—Comprehensive revisions to the NIPAs introduced in December 2003 significantly changed the way Federal transactions are measured in the NIPAs, and the ways in which the NIPAs differ from the budget. The three most important changes were: 1) reclassification of nontaxes out of current tax receipts into current transfer receipts from persons and from business (net); 2) switching several items formerly netted against expenditures to current receipts: interest and dividends received by Government, the current surplus of Government enterprises, and tax receipts from the rest of the world (formerly netted against transfer payments to the rest of the world); 3) a new receipts category called "income receipts on assets" now includes such items as Outer Continental Shelf oil and gas royalties. The categories into which Government current expenditures and current receipts are broken down in the NIPAs are now significantly different from those used in the past. Terminology has changed also; most notably, government surpluses or deficits are now referred to as net government saving. The effects of these changes are reflected in this chapter.

Netting differences arise when the budget records certain transactions as offsets to outlays while they are recorded as current receipts in the NIPAs (or vice versa). The budget treats all income that comes to the Government due to its sovereign powers—mainly, but not exclusively, taxes—as governmental receipts. The budget offsets against outlays any income that arises from voluntary business-type transactions with the public. The NIPAs often follow this concept as well, and income to Government enterprises such as the Postal Service or the power administrations is offset against their expenditures—but the NIPAs now treat the net surplus of Government enterprises as a component of current receipts. However, the NIPAs have a narrower definition of "business-type transactions". Two classes of receipts, rents and royalties, and regulatory or inspection fees, both of which are classified as offsets to outlays in the budget, are recorded in the NIPAs

[1] The other subsector of the NIPA government sector is a single set of transactions for all U.S. State and local units of government, treated as a consolidated entity.

[2] Over the period 1994–2003, NIPA current expenditures averaged four percent higher than budget outlays, while NIPA current receipts averaged two percent higher than budget receipts.

as Government receipts (income receipts on assets and current transfer receipts, respectively). The NIPAs include Medicare premiums as Government receipts, while the budget classifies them as business-type transactions (offsetting receipts).

In the budget, any intragovernmental income from one account to another is offset against outlays rather than being recorded as a receipt so that total outlays and receipts measure transactions with the public. Government contributions for Federal employee social insurance (such as social security) is an example: the budget offsets these payments against outlays. In contrast, the NIPAs treat the Federal Government like any other employer and show contributions for Federal employee social insurance as expenditures by the employing agencies and as governmental (rather than offsetting) receipts. The NIPAs also impute certain transactions that are not explicit in the budget. For example, unemployment benefits for Federal employees are financed by direct appropriations rather than social insurance contributions. The NIPAs impute social insurance contributions by employing agencies to finance these benefits—again, treating the Federal Government like any other employer.

Timing differences for receipts occur because the NIPAs generally record personal taxes and social insurance contributions when they are paid and business taxes when they accrue, while the budget generally records all receipts when they are received. Thus the NIPAs attribute corporations' final settlement payments back to the quarter(s) in which the profits that gave rise to the tax liability occurred. The delay between accrual of liability and Treasury receipt of payment can result in significant timing differences between NIPA and budget measures of receipts for any given accounting period.

Timing differences also occur for expenditures. When the first of a month falls on a weekend or holiday, monthly benefit checks normally mailed on the first of the month may be mailed out a day or two earlier; the budget then reflects two payments in one month and none the next. On occasion, the budget totals reflect 13 monthly payments in one year and only 11 the next. NIPA expenditure figures always reflect 12 benefit payments per year, giving rise to a timing difference compared to the budget.

Coverage differences also differentiate the budget and the NIPAs. The NIPA Federal subsector is a current account and excludes capital transfers unrelated to current economic production, which are included in the budget. Federal investment grants to State and local governments, investment subsidies to business, and forgiveness of debt owed by foreign governments are included as outlays in the budget but are excluded from NIPA current expenditures as being capital transfers. Likewise, estate and gift taxes, included in budget receipts, are excluded from NIPA current receipts as being capital transfers. Also unlike the budget, the NIPAs exclude transactions with U.S. territories. They also exclude the proceeds from the sales of nonproduced assets such as land. Bonuses paid on Outer Continental Shelf oil leases and proceeds from broadcast spectrum auctions are shown as offsetting receipts in the budget and are deducted from budget outlays. In the NIPAs these transactions are excluded as an exchange of assets with no current production involved.

A coverage difference arises on the expenditure side because of the NIPA treatment of Government investment. The budget includes outlays for Federal investments as they are paid, while the Federal sector of the NIPA instead excludes current investments but includes a depreciation charge on past investments ("consumption of general government fixed capital") as part of "current expenditures." The inclusion of depreciation on fixed capital (structures, equipment and software) in current expenditures is a proxy for the services that capital renders; i.e., for its contribution to Government output of public services.

The treatment of Government pension plan income and outgo creates a coverage difference. Whereas the budget treats employee payments to these pension plans as governmental receipts, and employer contributions by agencies as offsets to outlays because they are intragovernmental, the NIPAs treat both of these components of employee compensation as personal income, in the same way as it treats contributions to pension plans in the private (household) sector. Likewise, the budget records a Government check to a retired Government employee as an outlay, but under NIPA concepts, no Government expenditure occurs at that time; the payment is treated (like private pension payments) as a transfer of income within the household sector.

Financial transactions such as loan disbursements, loan repayments, loan asset sales, and loan guarantees are excluded from the NIPAs on the grounds that such transactions simply involve an exchange of assets rather than current production, income, or consumption. In contrast, under the Federal Credit Reform Act of 1990, the budget records the estimated subsidy cost of the direct loan or loan guarantee as an outlay when the loan is disbursed. The cash flows with the public are recorded in nonbudgetary accounts as a means of financing the budget rather than as budgetary transactions themselves. This treatment recognizes that part of a Federal direct loan is an exchange of assets with equal value but part is a subsidy to the borrower. It also recognizes the subsidy normally granted by loan guarantees. In the NIPAs, neither the subsidies nor the loan transactions are included. However, the NIPAs, like the budget, include all interest transactions with the public, including interest received and paid to the loan financing accounts.

Deposit insurance outlays for resolving failed banks and thrift institutions are similarly excluded from the NIPAs on the grounds that there are no offsetting current income flows from these transactions. In 1991, this exclusion was the largest difference between the NIPAs and the budget and made NIPA net Government saving a significantly smaller negative number than the budget deficit that year. In subsequent years, as assets acquired from failed financial institutions were sold, these collections tended to make the budget deficit a smaller negative figure than NIPA net Federal Government saving.

Table 13–1. FEDERAL TRANSACTIONS IN THE NATIONAL INCOME AND PRODUCT ACCOUNTS, 2003–2005

(In billions of dollars)

Description	Actual 2003	Estimate	
		2004	2005
CURRENT RECEIPTS			
Current tax receipts	1,029.8	1,009.2	1,210.1
Personal current taxes	781.7	721.0	850.4
Taxes on production and imports	90.3	97.4	97.0
Taxes on corporate income	151.0	184.1	256.0
Taxes from the rest of the world	6.8	6.7	6.7
Contributions for Government social insurance	749.8	788.0	846.7
Income receipts on assets	21.4	23.6	24.0
Current transfer receipts	26.3	27.7	30.0
Current surplus of Government enterprises	2.9	–0.6	–1.4
Total current receipts	1,830.2	1,847.9	2,109.5
CURRENT EXPENDITURES			
Consumption expenditures	640.3	706.1	712.3
Defense	424.8	471.2	459.8
Nondefense	215.5	234.9	252.4
Current transfer payments	1,310.5	1,398.8	1,447.2
Government social benefits	955.7	1,010.1	1,060.1
Grants-in-aid to State and local governments	333.3	360.6	356.5
To the rest of the world	21.5	28.1	30.6
Interest payments	217.8	218.5	243.8
Subsidies	49.3	44.0	44.2
Wage disbursements less accruals	....	....	....
Total current expenditures	2,218.0	2,367.4	2,447.4
Net Federal Government saving	–387.8	–519.5	–338.0
ADDENDUM			
Capital transfer payments (net)	–23.2	–23.4	–26.7
Gross Government investment:			
Defense	58.6	63.8	67.0
Nondefense	37.0	40.8	43.2

* $50 million or less.

Federal Sector Current Receipts

Table 13–1 shows Federal current receipts in the five major categories and four of the subcategories now used in the NIPAs, which are similar to the budget categories but with significant differences.

Current tax receipts is the largest major category of current receipts, and its personal current taxes subcategory— composed primarily of the individual income tax—is the largest single subcategory. The NIPAs' taxes on corporate income subcategory differs in classification from the corresponding budget category primarily because the NIPAs include the deposit of earnings of the Federal Reserve System as corporate profits taxes, while the budget treats these collections as miscellaneous receipts. (The timing difference between the NIPAs and the budget is especially large for corporate receipts.) The taxes on production and imports subcategory is composed of excise taxes and customs duties.

Contributions for Government social insurance is the second largest major category of current receipts. It differs from the corresponding budget category primarily because: (1) the NIPAs include Federal employer contributions for social insurance as a governmental receipt, while the budget offsets these contributions against outlays as undistributed offsetting receipts; (2) the NIPAs include premiums for Part B of Medicare as governmental receipts, while the budget nets them against outlays; (3) the NIPAs treat Government employee contributions to their pension plans as personal income, while the budget includes them in governmental receipts; and (4) the NIPAs impute employer contributions for Federal employees' unemployment insurance and workers' compensation.

The income receipts on assets category consists mainly of interest payments received on Government direct loans (such as student loans) and rents and royalties on Outer Continental Shelf oil leases. The current transfer receipts category consists primarily of deposit insurance premiums, fees, fines and other receipts from both individuals and businesses—virtually all of which are netted against outlays in the budget. The current surplus (or deficit) of Government enterprises category was formerly netted against subsidies on the expenditure side of the accounts. This is the profit or loss of "Government enterprises," such as the Postal Service, which are business-type operations of Government that usually appear in the budget as public enterprise revolving funds. Depreciation (consumption of enterprise fixed capital) is netted in calculating the current surplus of Government enterprises.

Federal Sector Current Expenditures

Table 13–1 shows current expenditures in five major NIPA categories and five subcategories, which are also very different from the budget categories.

Government consumption expenditures are the goods and services purchased by the Federal Government in the current account, including compensation of employees and depreciation. Gross investment (shown as addendum items in Table 13–1) is thus excluded from current expenditures in computing net Government saving on a NIPA basis, whereas depreciation—charges on federally owned fixed capital—("consumption of general government fixed capital") is included. The NIPAs treat State and local investment and capital consumption in the same way—regardless of the extent to which it is financed with Federal aid (capital transfer payments) or from State and local own-source receipts.

Although gross investment is not included in Government current expenditures, both Government gross investment and current consumption expenditures (including depreciation) are included in total GDP, which makes the treatment of the government sectors in the NIPAs similar to that of the private sector. Investment includes structures, equipment, and computer software.

Current transfer payments is the largest expenditure category. Transfer payments for Government social benefits consist mainly of income security and health programs, such as Social Security and Medicare paid to U.S. residents—and to retirees living outside the U.S. Payment of pension benefits to former Government employees is not included, as explained previously. Grants-in-aid to State and local governments help finance a range of programs, including income security, Medicaid, and education (but capital transfer payments for construction of highways, airports, waste-water treatment plants, and mass transit are excluded). "Current transfer payments to the rest of the world (net) consists mainly of grants to foreign governments.

Interest payments is the interest paid by the Government on its debt (excluding debt held by trust funds, other than Federal employee pension plans; and other Government accounts). Where the budget nets interest received on loans against outlays, the NIPAs now treat it as current receipts.

Subsidies consist of subsidy payments for resident businesses (excluding subsidies for investment). NIPA subsidies do not include the imputed credit subsidies estimated as budget outlays under credit reform. Rather, loans and guarantees are categorized as financial transactions and are excluded from the NIPAs except for associated interest and fees.

Wage disbursements less accruals is an adjustment that is necessary to the extent that the wages paid in a period differ from the amount earned in the period.

Differences in the Estimates

From the introduction of the unified budget in January 1968 until the early 1990s, NIPA receipts were less than budget receipts in most years. This was due principally to the fact that estate and gift taxes, which they exclude as capital transfers, exceeded Medicare premiums, which they include as a governmental receipt but the budget treats as an offsetting receipt. (In the budget, offsetting receipts are netted against the outlay total and not included in the governmental receipts total.) NIPA current expenditures have usually been higher than budget outlays (from which the Medicare premiums and employer retirement contributions are netted out as offsetting receipts), despite the omission from NIPA expenditures of capital transfer grants and pension benefit payments to former Government employees.

Two components of budget outlays, however, are sometimes sufficiently large in combination to exceed the netting adjustments. These are financial transactions and net investment (the difference between gross investment and depreciation). Large outlays associated with resolving the failed savings and loan associations and banks in 1990 and 1991 caused those year's budget outlays to exceed NIPA current expenditures. With the change in budgetary treatment of direct loans in 1992 under credit reform, one type of financial transaction—direct loans to the public—has been recorded in the budget in a way that is closer to the NIPA treatment. Disbursement and repayment of loans made since that time are recorded outside the budget as in the Federal sector of the NIPAs, although, unlike the NIPAs, credit subsidies are recorded as budget outlays.

Table 13–2. RELATIONSHIP OF THE BUDGET TO THE FEDERAL SECTOR, NIPAs

	Actual 2003	Estimate	
		2004	2005
RECEIPTS			
Budget receipts	1,782.3	1,798.1	2,036.3
Contributions to Government employee retirement plans	–4.6	–4.7	–4.7
Capital transfers received	–21.8	–23.8	–21.3
Other coverage differences	–9.8	–10.8	–10.9
Netting and grossing	86.1	91.6	98.4
Timing differences	–2.0	–2.6	11.8
NIPA current receipts	1,830.2	1,847.9	2,109.5
EXPENDITURES			
Budget outlays	2,157.6	2,318.8	2,399.8
Government employee retirement plan transactions	29.3	31.8	31.5
Deposit insurance and other financial transactions	16.8	7.9	15.2
Capital transfer payments	–45.0	–47.2	–48.0
Net purchases of nonproduced assets	–0.1	–0.1	–0.1
Net investment	–5.2	–11.7	–14.4
Other coverage differences	–20.1	–27.6	–37.1
Netting and grossing differences	86.1	91.6	98.4
Timing differences	–1.6	3.8	2.0
NIPA current expenditures	2,218.0	2,367.4	2,447.4
ADDENDUM			
Budget deficit (–)	–375.3	–520.7	–363.6
NIPA net Federal Government saving	–387.8	–519.5	–338.0

* $50 million or less.

During the period 1975–1992, the budget deficit was a larger negative number than net Federal Government saving as measured in the NIPAs' seasonally adjusted data every year except 1987. The largest difference, $72.9 billion, occurred in 1991 as a result of resolving failed financial institutions as discussed above; the budget deficit was then –$269.3 billion, while the NIPA net Government saving was –$196.5 billion. In 1993–2003, the NIPA net Federal Government saving were larger negative numbers than the budget deficit or lower positive numbers than the budget surplus each year. For 2004 and 2005, the NIPA net Federal Government saving are projected to be smaller negative numbers than the budget deficit.

Table 13–1 displays Federal transactions using NIPA concepts with actual data for the 2003 and estimates for 2004 and 2005 consistent with the Administration's budget proposals. Table 13–2 summarizes the reasons for differences between the data. Table 13–3 displays quarterly data using NIPA concepts beginning in October 2002. Annual NIPA data for 2003–2005 are published in Section 14 of a separate budget volume, *Historical Tables, Budget of the U.S. Government, Fiscal Year 2005*.

Detailed estimates of NIPA current receipts and expenditures will be published in a forthcoming issue of the Department of Commerce publication, *Survey of Current Business* and on the Bureau of Economic Analysis website at *http://www.bea.doc.gov/bea/pubs.htm*.

Table 13–3. FEDERAL RECEIPTS AND EXPENDITURES IN THE NIPA's, QUARTERLY, 2003–2005

(In billions of dollars; seasonally adjusted at annual rates)

Description	Actual				Estimate							
	Oct.-Dec.	Jan.-Mar.	Apr.-June	July-Sept.	Oct.-Dec.	Jan.-Mar.	Apr.-June	July-Sept.	Oct.-Dec.	Jan.-Mar.	Apr.-June	July-Sept.
	2002	2003	2003	2003	2003	2004	2004	2004	2004	2005	2005	2005
CURRENT RECEIPTS												
Current tax receipts	1,072.7	1,060.3	1,057.1	972.1		978.1	1,008.6	1,042.4	1,080.4	1,186.3	1,222.7	1,256.6
Personal current taxes	815.4	794.3	794.6	696.3		681.5	695.3	712.9	734.2	813.4	836.3	857.8
Taxes on production and imports	89.0	88.3	87.7	86.3		93.7	97.5	98.1	94.7	93.9	94.9	95.7
Taxes on corporate income	161.7	171.0	167.9	182.8		196.3	209.1	224.7	244.9	272.3	284.8	296.4
Taxes from the rest of the world	6.7	6.8	6.9	6.7		6.7	6.7	6.7	6.7	6.7	6.7	6.7
Contributions for Government social insurance	741.9	755.1	758.5	763.1		791.6	802.4	815.1	824.5	844.0	854.6	864.4
Income receipts on assets	22.0	22.5	23.6	24.9		25.6	25.7	25.5	25.5	25.8	26.1	26.5
Current transfer receipts	25.4	26.0	26.3	26.9		27.6	28.1	28.7	29.5	30.0	30.5	30.8
Current surplus of Government enterprises	–2.3	–0.4	–1.6	–2.5		–5.7	–5.7	–5.7	–5.7	–6.1	–6.2	–6.1
Total current receipts	1,859.7	1,863.5	1,863.9	1,784.3		1,817.2	1,859.1	1,906.1	1,954.2	2,080.1	2,127.6	2,172.2
CURRENT EXPENDITURES												
Consumption expenditures	620.7	635.9	668.9	672.3		711.4	723.5	730.2	728.0	724.5	721.2	719.5
Defense	404.6	408.6	447.5	443.7		468.2	475.2	477.6	471.0	462.8	457.3	454.2
Nondefense	216.1	227.3	221.4	228.5		243.2	248.3	252.6	257.1	261.7	263.9	265.3
Current transfer payments	1,270.8	1,287.3	1,339.5	1,348.9		1,392.7	1,404.7	1,424.8	1,433.9	1,457.8	1,452.2	1,452.3
Government social benefits	935.4	951.5	969.7	979.7		1,012.3	1,025.1	1,037.4	1,048.9	1,065.4	1,070.6	1,075.4
Grants-in-aid to State and local governments	316.4	310.8	345.5	346.3		343.7	352.9	360.4	355.4	353.2	352.4	347.2
To the rest of the world	19.1	25.1	24.3	22.9		36.8	26.7	27.1	29.5	39.2	29.3	29.7
Interest payments	227.6	217.7	222.5	215.6		218.5	222.1	227.3	235.5	242.7	250.1	257.6
Subsidies	37.0	44.5	56.3	47.0		41.9	40.0	37.8	38.3	40.3	42.3	43.5
Wage disbursements less accruals	....	–1.4	1.4	....		....	....	....	....	....	....	....
Total current expenditures	2,156.1	2,184.0	2,288.5	2,283.7		2,364.4	2,390.2	2,420.3	2,435.7	2,465.3	2,465.9	2,472.9
Net Federal Government saving	–296.3	–320.4	–424.7	–499.4		–547.3	–531.1	–514.2	–481.5	–385.3	–338.2	–300.7
ADDENDUM												
Capital transfer payments (net)	–19.8	–13.8	–28.4	–29.6		–22.9	–23.9	–23.5	–24.8	–25.7	–26.1	–26.5
Gross Government investment:												
Defense	56.6	54.7	59.8	63.5		65.6	65.5	62.4	66.6	67.2	65.9	68.5
Nondefense	32.7	32.4	36.0	33.8		34.3	34.7	35.1	35.4	36.3	37.4	38.7

Department of Commerce advance estimates for the Oct.-Dec. quarter, released January 30, 2004, were not available in time for inclusion in this table.

* $50 million or less.

BUDGET REFORM PROPOSALS

14. BUDGET REFORM PROPOSALS

On September 30, 2002, the budget regimen that enforced fiscal restraint for most of the past decade expired. The Budget Enforcement Act of 1990, originally enacted to address budget deficits, was an effective constraint until budget surpluses surfaced in 1998. With growing surpluses, the Act's requirements were either circumvented or explicitly waived. The Administration will send the Congress a comprehensive budget enforcement legislative package shortly after the Budget is transmitted. This chapter provides an overview of the Administration's proposals.

Discretionary Caps and PAYGO

Discretionary Caps.—The Administration proposes to set limits for 2005 through 2009 on net budget authority and outlays equal to the levels proposed in the 2005 Budget. Legislation that exceeds the discretionary caps would trigger a sequester of non-exempt discretionary programs. Table 14–1 displays the total levels of discretionary budget authority and outlays proposed for 2005 through 2009. This approach would put in place a budget framework for the next five years that ensures reasonable, but modest growth in discretionary programs. The proposal discontinues separate caps for conservation programs and provides for a single, discretionary cap with separate firewalls for Transportation programs only. A single cap restrains overall discretionary spending growth, while providing the President and Congress the greatest flexibility for making decisions on the allocation of these resources.

Within the discretionary levels, the Administration will propose an adjustment for spending above a base level of funding for Social Security Administration Continuing Disability Reviews (CDRs). Additional spending on CDRs has proven to reduce erroneous payments in this program. In the past, every $1 expended on CDRs has produced a $10 return to the taxpayer. The Administration's proposed adjustment in 2005 is $561 million for these activities. The Administration will support an adjustment above the baseline amount not to exceed a total funding level of $604 million in 2006 and $662 million in 2007 through 2009 for these activities.

Transportation Firewalls.—The Administration's proposal for discretionary caps includes separate firewalls for spending on Federal Highway and Mass Transit programs. The Transportation levels will be financed by dedicated revenues over a six-year period from 2004 through 2009. This structure is consistent with the 2004 through 2009 estimates provided in the 2005 budget. As in the previous authorization, the Transportation Equity Act for the 21st Century, the Highway obligations would receive an annual adjustment reflecting updated revenue estimates beginning in 2006. Table

Table 14–1. GENERAL PURPOSE DISCRETIONARY CAPS AND ADJUSTMENTS

(Amounts in billions of dollars)

	2005	2006	2007	2008	2009
Proposed Discretionary Spending Categories:					
Discretionary Category:					
Budget authority	813.8	842.3	867.0	892.4	918.0
Outlays	872.7	850.7	862.8	881.3	900.3
Proposed Cap Adjustment:					
SSA Continuing Disability Reviews:					
Budget authority	0.6	0.6	0.7	0.7	0.7
Outlays	0.6	0.6	0.7	0.7	0.7
Total, Discretionary Category:					
Budget authority	814.4	842.9	867.6	893.0	918.7
Outlays	873.3	851.4	863.5	881.9	901.0
Highway Category:					
Outlays	33.2	33.9	34.2	34.5	34.7
Mass Transit Category: [1]					
Outlays	7.5	7.0	6.7	6.5	6.6
Total, All Discretionary:					
Budget authority	814.4	842.9	867.6	893.0	918.7
Outlays	914.0	892.3	904.4	922.9	942.3
Project BioShield Category:					
Budget authority	2.5	....	....	....	2.2

[1] Includes prior-year outlays from general fund budget authority provided in years prior to 2004. Outlays from general fund budget authority for 2004 and beyond are included in the Discretionary Category.

Table 14–2. TRANSPORTATION GUARANTEE FOR HIGHWAYS AND MASS TRANSIT SPENDING

(Amounts in billions of dollars)

	[1]2004	2005	2006	2007	2008	2009
Transportation Guarantee:						
Highways:						
Obligation Limitations	34.3	34.6	34.7	34.7	34.7	34.7
Outlays	31.2	33.2	33.9	34.2	34.5	34.7
Mass Transit: [2]						
Obligation Limitations	5.8	6.0	6.0	6.0	6.0	6.0
Outlays	7.6	7.5	7.0	6.7	6.5	6.6
Memorandum:						
Discretionary budget authority for Mass Transit not under the Transportation Guarantee:						
Budget authority	*1.5*	*1.3*	*1.3*	*1.3*	*1.3*	*1.3*

[1] 2004 is displayed to show the Administration's complete SAFETEA proposal for Highway and Mass Transit programs through 2009.

[2] Includes prior-year outlays from general fund budget authority provided in years prior to 2004. Outlays from general fund budget authority for 2004 and beyond are included in the Discretionary Category.

14–2 displays the Administration's Transportation proposal.

Project BioShield Category.—The Administration proposes to create a separate BEA category for budget authority (BA) for Project BioShield, which received an advance appropriation for 2005 of $2.5 billion and for 2009 of $2.2 billion in P.L. 108–90, the 2004 Department of Homeland Security Appropriations Act. Because the success of this program in providing for the development of vaccines and medications for biodefense depends on an assured funding availability, it is critical that this funding not be diverted to other purposes. As a result, the Administration proposal to create a separate category will help ensure the funding for this program is not reduced and used as an offset for other discretionary spending.

Pay-As-You-Go (PAYGO) Extension.—The Administration proposes to extend the pay-as-you-go requirement for mandatory spending only. Revenue legislation would not be subject to this requirement. The five-year impact of any proposals affecting mandatory spending would continue to be scored. Table 14–3 displays the President's direct spending proposals. Legislation that exceeds the pay-as-you-go requirement over a two-year period would trigger a sequester of direct spending programs. The 2005 Budget identifies as "PAYGO" only legislative proposals that change direct spending.

In the case of the President's proposed health care credit, the Budget includes contingent offsets that would cover the estimated increases in mandatory spending that would result from this proposal. When the Congress moves legislation to implement the President's health care credit proposal, the Administration will work with the Congress to offset this additional spending.

Advance Appropriations

An advance appropriation becomes available one or more years beyond the year for which its appropriations act is passed. BA is recorded in the year the funds become available, not in the year enacted. Too often, advance appropriations have been used to expand spending levels by shifting budget authority from the budget year into the subsequent year and then appropriating the BA freed up under the budget year discretionary cap to other programs. From 1993 to 1999, an average of $2.3 billion in discretionary budget authority was advance appropriated each year. In 1999, advance appropriations totaled $8.9 billion and increased to $23.4 billion in 2000.

Table 14–3. PAYGO PROPOSALS

(Cost in millions of dollars)

	2004	2005	2006	2007	2008	2009	2005–2009
PAYGO proposals:							
Refundable Portion of the Health Care Tax Credit	....	82	3,760	5,041	6,388	7,133	22,404
Contingent Offset for Refundable Portion of the Health Care Tax Credit	....	–82	–3,760	–5,041	–6,388	–7,133	–22,404
Medicaid/State Children's Health Insurance Program Proposals	175	–653	–891	–965	–1,022	–1,075	–4,431
Extension of Bureau of Customs and Border Protection's Fees	....	–820	–1,391	–1,448	–1,507	–1,570	–6,736
Reclassification of Nuclear Waste Disposal Fees as Discretionary	....	749	754	757	767	767	3,794
Extension of Spectrum Auction Authority and Authorization of Fees	....	....	–50	1,850	1,700	–3,100	400
Other Proposals	6	–597	–652	463	–614	–579	–1,975
Total	**181**	**–1,321**	**–2,231**	**657**	**–676**	**–5,557**	**–8,947**
Total, 2004 and 2005	....	**–1,140**	....	....	....	....	....

Because this budget practice distorts the debate over Government spending and misleads the public about spending levels in specific accounts, the President's budget proposals and the 2002 Congressional Budget Resolution capped advance appropriations at the amount advanced in the previous year. This year, the Administration proposes that total advance appropriations, excluding BioShield, continue to be capped in 2005 through 2009 at the 2002 level so that increases in these and other programs will be budgeted and reflected in the year of their enactment. Accordingly, the 2005 Budget freezes all advance appropriations at their 2002 levels, except for those that should be reduced or eliminated for programmatic reasons. To enforce these levels, the discretionary cap proposal provides that any advance appropriations provided in an appropriations act for 2005 through 2009 in excess of the advance appropriations provided in 2002 will count against the discretionary cap in the year enacted.

Include Stricter Standard For Emergency Designation in the BEA

When the BEA was created, it provided a "safety-valve" to ensure that the fiscal constraint envisioned by the BEA would not prevent the enactment of legislation to respond to unforeseen disasters and emergencies such as Operation Desert Storm, Hurricane Andrew, or the terrorist attacks of September 11, 2001. If the President and the Congress separately designated a spending or tax item as an emergency requirement, the BEA held these items harmless from its enforcement mechanisms. Initially, this safety valve was used judiciously, but in later years its application was expanded to circumvent the discretionary caps by declaring spending for ongoing programs as "emergencies." Declaration of the 2000 Census as an emergency requirement—despite being required by the Constitution—is but one egregious example.

The Administration proposes to include in the BEA a definition of "emergency requirement" that will ensure high standards are met before an event is deemed an "emergency" and therefore exempt. This definition should include the following elements: the requirement is a necessary expenditure that is sudden, urgent, unforeseen, and not permanent. These elements, all of which would be necessary for defining something as an emergency, are defined as follows:

- **necessary expenditure**—an essential or vital expenditure, not one that is merely useful or beneficial;
- **sudden**—quickly coming into being, not building up over time;
- **urgent**—pressing and compelling, requiring immediate action;
- **unforeseen**—not predictable or seen beforehand as a coming need (an emergency that is part of the average annual level of disaster assistance funding would not be "unforeseen"); and
- **not permanent**—the need is temporary in nature.

The Administration proposal would also require that the President and Congress concur in designating an emergency for each spending proposal covered by a designation. This would protect against the "bundling" of non-emergency items with true emergency spending. If the President determines that specific proposed emergency designations do not meet this definition, he would not concur in the emergency designation and no discretionary cap adjustment or PAYGO exemption would apply.

Baseline

The Administration proposes several changes to Section 257 of the BEA, which establishes the requirements for the baseline:

- Correct the overcompensation of baseline budgetary resources for pay raise-related costs due to the way in which these costs are inflated. The current requirement, which provides a full year's funding for pay raises in the budget year and beyond, was written when Federal pay raises were scheduled to take effect on October 1, at the start of each fiscal year. However, this requirement is now inappropriate because the effective date for pay raises is now permanently set by law as the first pay period in January. By treating pay raises that begin on January 1 as if they take effect for the entire fiscal year, the baseline overstates the cost of providing a constant level of services.
- Eliminate the adjustments for expiring housing contracts and social insurance administrative expenses. Most multi-year housing contracts have expired or have been addressed since the BEA was first enacted in 1990, so the adjustment is no longer needed. The adjustment for social insurance administrative expenses is also inconsistent with the baseline rules for other accounts that fund the costs of administration and should not be singled out for preferential treatment.
- Assume extension of all expiring tax provisions in the Economic Growth and Tax Relief Reconciliation Act of 2001 and certain provisions in the Jobs and Growth Tax Relief Reconciliation Act of 2003. The BEA currently has inconsistent treatment for mandatory spending and revenues. In the case of major entitlement programs, the law assumes these programs are extended. In the case of 2001 and 2003 tax laws, however, the BEA does not provide for their extension. The BEA's treatment of revenues is also inconsistent. The BEA assumes taxes dedicated to trust funds that are scheduled to expire are extended, but does not assume tax reductions are extended. The provisions that will be extended were clearly not intended to be temporary.
- Add a provision to exclude discretionary funding for emergencies from the baseline. Instead, the baseline would include emergency funding only for the year in which it was enacted. The current requirement is for the discretionary baseline esti-

mates for the budget year and the outyears to assume the current year appropriated level, adjusted for inflation. This is reasonable for ongoing programs, where the need is expected to continue into the future. For emergencies, since the need should be for a short duration, the baseline rules build unnecessary funding into the baseline estimates for the years after the need has been addressed and passed. In effect, the current rule biases the baseline in favor of higher discretionary spending.

Scoring Rule Changes

Federal Pell Grants.—The Pell Grant program provides grant aid to postsecondary students to help pay for their education. While Pell Grant funding is discretionary, if a Pell-eligible student enrolls in school, he or she is automatically eligible for a need-based award up to the maximum award set in appropriations (currently $4,050), regardless of the budget authority appropriated. Pell Grant cost estimates are based on the February Budget's technical and economic assumptions.

The Administration proposes to score budget authority to the appropriators for the amount necessary to cover Pell Grant program costs in the upcoming award year, based on the February Budget's economic and technical assumptions. Currently, Pell Grant outlays are scored based on the full cost of the appropriations provisions (the maximum award and, in some cases, changes to eligibility requirements made in appropriations). However, Pell Grant budget authority is scored at the level specified in appropriations language. The Administration's proposed scoring rule change would remove any incentive to appropriate less than the estimated program cost for the Federal Pell Grant program, or to increase program costs (for instance, by increasing the maximum award) without providing the necessary budget authority.

Pay Raises.—The Administration proposes a rule to enforce the annual pay raise for Federal employees in order to avoid the substantial future costs associated with higher pay raises. To accomplish this, the budget resolution would specify pay raises assumed for military and Federal civilian employees for the budget year. A point of order would lie against any provision containing a pay raise greater than that assumption.

Long-term Unfunded Obligations.—The Administration proposes new measures to prevent enactment of legislation that worsens the long-term unfunded obligations of Federal entitlement programs. As discussed in Chapter 12 of this volume, "Stewardship," spending by the Government's major entitlement programs, particularly Social Security and Medicare, is projected to rise in the next few decades to levels that cannot be sustained, either by those programs' own dedicated financing or by general revenues. The Administration's proposed measures would prevent further legislative increases in the long-run fiscal imbalance.

First, the Administration proposes a point of order against legislation which worsens the long-term unfunded obligation of major entitlements. The specific programs covered would be those programs with long-term actuarial projections, including Social Security, Medicare, Federal civilian and military retirement, veterans disability compensation, and Supplemental Security Income. Additional programs would be added once it becomes feasible to make long-term actuarial estimates for those programs.

Second, the Administration proposes new reporting requirements to highlight legislative actions worsening unfunded obligations. These requirements would require the Administration, as part of the President's budget, to report on any enacted legislation in the past year that worsens the unfunded obligations of the specified programs. The Congressional Budget Office would also be required to make a similar report in its annual publication on the economic and budget outlook.

Other Budget Reform Proposals

Joint Budget Resolution.—A joint budget resolution would set the overall levels for discretionary spending, mandatory spending, receipts, and debt in a simple document that would have the force of law. Under the current process, the Congress annually adopts a "concurrent resolution," which does not require the President's signature and does not have the force of law.

A joint budget resolution could be enforced by sequesters requiring automatic across-the-board cuts to offset any excess spending, similar to the BEA. It would bring the President into the process at an early stage, require the President and the Congress to reach agreement on overall fiscal policy before individual tax and spending bills are considered, and avoid the "train wrecks" that occurred just prior to expiration of the BEA.

Biennial Budgeting and Appropriations.—Only twice in the last 50 years have all appropriation bills been enacted by the beginning of the fiscal year. Because Congress must enact these bills each year, it cannot devote the time necessary to provide oversight and resolve problems in other programs. The preoccupation with these annual appropriations bills frequently precludes review and action on the growing portion of the budget that is permanently funded under entitlement laws. According to the Congressional Budget Office, the total amount of unauthorized appropriations in recent years has ranged from roughly $90–$120 billion annually.

In contrast, a biennial budget would allow lawmakers to devote more time every other year to ensuring that taxpayers' money is spent wisely and efficiently. In addition, Government agencies would receive more stable funding, which would facilitate longer range planning and improved fiscal management. Under the President's proposal for a biennial budget, funding decisions would be made in odd-numbered years, with even numbered years devoted to authorizing legislation.

Line-Item Veto.—A perennial criticism of the Federal Government is that spending and tax legislation often contain provisions benefiting a relative few which would not likely become law if not attached to other bills.

The President proposes that the Congress correct this state of affairs by providing him with a constitutional line item veto. From the Nation's founding, Presidents have exercised the authority to not spend appropriated sums. However, this authority was curtailed in 1974 when Congress passed the Impoundment Control Act, which restricted the President's authority to decline to spend appropriated sums. The Line Item Veto Act of 1996 attempted to give the President the authority to cancel spending authority and special interest tax breaks, but the U.S. Supreme Court found that law unconstitutional. The President's proposal would correct the constitutional flaw in the 1996 Act.

Specifically, the President proposes a line-item veto linked to deficit reduction. This proposal would give the President the authority to reject new appropriations, new mandatory spending, or limited grants of tax benefits (to 100 or fewer beneficiaries) whenever the President determines the spending or tax benefits are not essential Government priorities. All savings from the line-item veto would be used for deficit reduction, and could not be applied to other spending.

Government Shutdown Prevention.—For 22 out of the past 23 years, Congress has not finished its work by the October 1st deadline, the beginning of the new fiscal year. When Congress fails to enact appropriations bills, it funds the Government through "continuing resolutions" (CRs), which provide temporary funding authority for Government activities at current levels until the final appropriations bills are signed into law.

If Congress does not pass a CR or the President does not sign it, the Federal Government must shut down. Important Government functions should not be held hostage simply because Washington cannot cut through partisan strife to pass temporary funding bills. In the responsible process the President envisions, there should be a back-up plan to avoid the threat of a Government shutdown, although appropriations bills still would pass on time as the law requires. Under the President's proposal, if an appropriations bill is not signed by October 1 of the new fiscal year, funding would be automatically provided at the lower of the President's Budget or the prior year's level.

Reserve for Fully Accruing Federal Employees' Retirement.—Both the President's 2003 and 2004 Budgets proposed to correct a long-standing understatement of the true cost of thousands of government programs. For some time, the cost of benefits accruing under the Federal Employee's Retirement System (FERS) and Military Retirement System (MRS) and a portion of the accruing benefits of the old Civil Service Retirement System (CSRS) have been properly allocated to the affected salary and expense accounts, but the remainder (a portion of CSRS, other small retirement systems, and all civilian and military retiree health benefits) has been charged to central accounts. The full cost of accruing benefits should be allocated to the affected salary and expense accounts, so that budget choices for program managers and budget decision makers are not distorted by understated cost information. The Administration recommends that this be re-examined and proposes to work with the Congress to develop a solution that addresses the concerns with the Administration's previous proposals. The 2005 Budget includes a very limited proposal that would permit the Patent and Trademark Office, a fully fee-funded agency, to use the fees it collects to cover the current accruing cost of post-retirement annuities, and health and life insurance benefits.

FEDERAL BORROWING AND DEBT

15. FEDERAL BORROWING AND DEBT

Debt is the largest legally binding obligation of the Federal Government. At the end of 2003, the Government owed $3,914 billion of principal to the people who had loaned it the money to pay for past deficits. During that year, the Government paid the public around $162 billion of interest on this debt.

The budget shifted from surplus to deficit in 2002, and the deficit then grew sharply in 2003. This was primarily because of the recession, the prolonged decline in the stock market, increased spending in response to terrorism, and several measures of tax relief that were intended to stimulate the economy during the recession and provide an impetus for growth well into the future. As a result, the deficit is estimated to rise to a higher level in 2004 before declining. Debt held by the public as a percentage of GDP increases by small amounts through 2005 and then changes little through 2009.

Table 15–1. TRENDS IN FEDERAL DEBT HELD BY THE PUBLIC

(Dollar amounts in billions)

Fiscal Year	Debt held by the public:		Debt held by the public as a percent of:		Interest on the debt held by the public as a percent of: [3]	
	Current Dollars	FY 2000 dollars [1]	GDP	Credit market debt [2]	Total outlays	GDP
1946	241.9	1,821.2	108.6	n.a	7.4	1.8
1950	219.0	1,339.6	80.2	53.3	11.4	1.8
1955	226.6	1,217.1	57.2	43.2	7.6	1.3
1960	236.8	1,127.8	45.6	33.8	8.5	1.5
1965	260.8	1,161.6	37.9	26.9	8.1	1.4
1970	283.2	1,047.7	28.0	20.8	7.9	1.5
1975	394.7	1,074.6	25.3	18.4	7.5	1.6
1980	711.9	1,340.7	26.1	18.5	10.6	2.3
1985	1,507.3	2,164.7	36.3	22.3	16.2	3.7
1986	1,740.6	2,443.0	39.5	22.6	16.1	3.6
1987	1,889.8	2,584.8	40.6	22.3	16.0	3.4
1988	2,051.6	2,720.6	40.9	22.2	16.2	3.4
1989	2,190.7	2,796.4	40.6	22.0	16.5	3.5
1990	2,411.6	2,968.1	42.0	22.6	16.1	3.5
1991	2,689.0	3,189.8	45.3	24.1	16.2	3.6
1992	2,999.7	3,471.1	48.1	25.7	15.5	3.4
1993	3,248.4	3,675.5	49.4	26.6	14.9	3.2
1994	3,433.1	3,802.7	49.3	26.8	14.4	3.0
1995	3,604.4	3,910.2	49.2	26.7	15.8	3.3
1996	3,734.1	3,974.5	48.5	26.3	15.8	3.2
1997	3,772.3	3,946.4	46.1	25.3	15.7	3.1
1998	3,721.1	3,846.1	43.1	23.4	15.1	2.9
1999	3,632.4	3,705.7	39.8	21.4	13.8	2.6
2000	3,409.8	3,409.8	35.1	19.1	13.0	2.4
2001	3,319.6	3,243.7	33.1	17.5	11.6	2.1
2002	3,540.4	3,399.3	34.1	17.5	8.9	1.7
2003	3,913.6	3,697.3	36.1	17.8	7.5	1.5
2004 estimate	4,420.8	4,122.3	38.6	n.a	7.1	1.4
2005 estimate	4,791.9	4,413.2	39.8	n.a	7.9	1.6
2006 estimate	5,074.1	4,604.0	40.1	n.a	9.1	1.8
2007 estimate	5,333.0	4,759.9	40.2	n.a	10.1	2.0
2008 estimate	5,589.4	4,894.9	40.0	n.a	10.7	2.1
2009 estimate	5,844.4	5,016.3	39.8	n.a	11.2	2.2

n.a. = not available

[1] Debt in current dollars deflated by the GDP chain-type price index with fiscal year 2000 equal to 100.

[2] Total credit market debt owed by domestic nonfinancial sectors, modified in some years to be consistent with budget concepts for the measurement of Federal debt. Financial sectors are omitted to avoid double counting, since financial intermediaries borrow in the credit market primarily in order to finance lending in the credit market. Source: Federal Reserve Board flow of funds accounts. Projections are not available.

[3] Interest on debt held by the public is estimated as the interest on Treasury debt securities less the "interest received by trust funds" (subfunction 901 less subfunctions 902 and 903). The estimate of interest on debt held by the public does not include the comparatively small amount of interest paid on agency debt or the offsets for interest on Treasury debt received by other Government accounts (revolving funds and special funds).

Trends in Debt Since World War II

Table 15–1 depicts trends in Federal debt held by the public from World War II to the present and estimates from the present through 2009. (It is supplemented for earlier years by tables 7.1–7.3 in *Historical Tables,* which is published as a separate volume of the budget.) As this table shows, Federal debt peaked at 108.6 percent of GDP in 1946, just after the end of the war. From then until the 1970s, Federal debt grew gradually, but, due to inflation, it declined in real terms. Because of an expanding economy as well as inflation, Federal debt as a percentage of GDP decreased almost every year. With households borrowing large amounts to buy homes and consumer durables, and with businesses borrowing large amounts to buy plant and equipment, Federal debt also decreased almost every year as a percentage of the total credit market debt outstanding. The cumulative effect was impressive. From 1950 to 1975, debt held by the public declined from 80.2 percent of GDP to 25.3 percent, and from 53.3 percent of credit market debt to 18.4 percent. Despite rising interest rates, interest outlays became a smaller share of the budget and were roughly stable as a percentage of GDP.

During the 1970s, large budget deficits emerged as the economy was disrupted by oil shocks and inflation. The nominal amount of Federal debt more than doubled, and Federal debt relative to GDP and credit market debt stopped declining after the middle of the decade. The growth of Federal debt accelerated in the 1980s, and the ratio of Federal debt to GDP grew sharply. The ratio of Federal debt to credit market debt also rose, though to a much lesser extent. Interest outlays on debt held by the public, calculated as a percentage of either total Federal outlays or GDP, increased as well.

The growth of Federal debt held by the public was decelerating by the mid-1990s, however, and the debt declined markedly relative to both GDP and total credit market debt. It fell steadily from 49.4 percent of GDP in 1993 to 33.1 percent in 2001; and it fell more unevenly from 26.6 percent of total credit market debt in 1993 to 17.5 percent in 2001. Interest on this debt, relative to total outlays and GDP, declined as well. Interest as a share of outlays peaked at 16.5 percent in 1989 and then fell to 11.6 percent by 2001; interest as a percentage of GDP fell in a similar proportion.

The recent economic conditions and response to terrorism have stopped the downward trend in debt relative to GDP. The recession, the initially slow recovery, and the decline in the stock market reduced tax receipts; tax relief had the same effect; and spending increased for war and homeland security. As a result of the ensuing deficits, table 15–1 shows a rise in debt held by the public throughout the projection period. Even during this period, however, the increase in debt is estimated to slow down. Debt continues to rise by small amounts as a percentage of GDP in 2004 and 2005 and then changes little through 2009. By that year, debt is estimated to equal 39.8 percent of GDP.

Debt Held by the Public, Gross Federal Debt, and Liabilities Other Than Debt

The Federal Government issues debt securities for two principal purposes. First, it borrows from the public to finance the Federal deficit.[1] Second, it issues debt to Government accounts, primarily trust funds, that accumulate surpluses. By law, trust fund surpluses must generally be invested in Federal securities. The gross Federal debt is defined to consist of both the debt held by the public and the debt held by Government accounts. Nearly all the Federal debt has been issued by the Treasury and is sometimes called “public debt,” but a small portion has been issued by other Government agencies and is called “agency debt.”[2]

Borrowing from the public, whether by the Treasury or by some other Federal agency, has a significant impact on the economy. Borrowing from the public is normally a good approximation of the Federal demand on credit markets. Regardless of whether the proceeds are used productively for tangible or intangible investment, the Federal demand on credit markets has to be financed out of the saving of households and businesses, the State and local sector, or the rest of the world. Federal borrowing thereby competes with the borrowing of other credit market sectors for financial resources in the credit market. Borrowing from the public thus affects the size and composition of assets held by the private sector and the perceived wealth of the public. It also increases the amount of taxes required to pay interest to the public on Federal debt. Borrowing from the public is therefore an important concern of Federal fiscal policy.[3]

Issuing debt securities to Government accounts performs an essential function in accounting for the operation of these funds. The balances of debt represent the cumulative surpluses of these funds due to the excess of their tax receipts, interest receipts, and other collections compared to their spending. The interest on the debt that is credited to these funds accounts for the fact that some earmarked taxes and user fees will be spent at a later time than when the funds receive the monies. The debt securities are a liability of the

[1] Debt held by the public was measured until 1988 as the par value (or face value) of the security, which is the principal amount due at maturity. (The only exception was savings bonds.) However, most Treasury securities are sold at a discount from par, and some are sold at a premium. Treasury debt held by the public is now measured as the sales price plus the amortized discount (or less the amortized premium). At the time of sale, the book value equals the sales price. Subsequently, it equals the sales price plus the amount of the discount that has been amortized up to that time. In equivalent terms, the book value of the debt equals par less the unamortized discount. (For a security sold at a premium, the definition is symmetrical.) When the measurement was changed, the data in *Historical Tables* were revised as far back as feasible, which was 1956. Agency debt, except for zero-coupon certificates, is recorded at par. For further analysis of these concepts, see Special Analysis E, “Borrowing and Debt,” in *Special Analyses, Budget of the United States Government,* Fiscal Year 1990, pages E–5 to E–8, although some of the practices it describes have been revised. In 1997 Treasury began to sell inflation-indexed notes and bonds. The book value of these securities includes a periodic adjustment for inflation.

[2] The term “agency debt” is defined more narrowly in the budget than customarily in the securities market, where it includes not only the debt of the Federal agencies listed in table 15–3 but also the debt of the Government-sponsored enterprises listed in table 7–9 at the end of chapter 7 and certain Government-guaranteed securities.

[3] The Federal subsector of the national income and product accounts provides a measure of “net government saving” (based on current expenditures and current receipts) that can be used to analyze the effect of Federal fiscal policy on national saving within the framework of an integrated set of measures of aggregate U.S. economic activity. The Federal subsector and its differences from the budget are discussed in chapter 13 of this volume, “National Income and Product Accounts.”

Table 15–2. FEDERAL GOVERNMENT FINANCING AND DEBT

(In billions of dollars)

	2003 Actual	Estimate					
		2004	2005	2006	2007	2008	2009
Financing:							
Unified budget deficit (–)	–375.3	–520.7	–363.6	–267.6	–241.3	–239.0	–237.1
Financing other than the change in debt held by the public:							
Net purchases (–) of non-Federal securities by the National Railroad Retirement Investment Trust	–20.2	–0.7	0.1	0.1	0.3	0.3	0.5
Changes in: [1]							
Treasury operating cash balance	25.9	–*	....	....	....	....	....
Compensating balances [2]	–5.2	22.2	....	....	....	....	....
Checks outstanding, etc. [3]	8.2	....	....	....	....	....	....
Seigniorage on coins	0.6	0.6	0.7	0.7	0.7	0.7	0.7
Less: Net financing disbursements:							
Direct loan financing accounts	–6.5	–11.8	–11.5	–18.8	–20.1	–20.3	–20.7
Guaranteed loan financing accounts	–0.7	3.3	3.2	3.4	1.5	1.8	1.6
Total, financing other than the change in debt held by the public	2.1	13.6	–7.5	–14.6	–17.6	–17.4	–17.9
Total, requirement to borrow from the public	–373.2	–507.2	–371.1	–282.3	–258.9	–256.4	–255.0
Change in debt held by the public	373.2	507.2	371.1	282.3	258.9	256.4	255.0
Change in Debt Subject to Statutory Limitation:							
Change in debt held by the public	373.2	507.2	371.1	282.3	258.9	256.4	255.0
Change in debt held by Government accounts	188.4	219.3	275.4	311.2	332.6	356.8	378.0
Change in other factors	14.6	0.3	0.5	0.2	0.5	0.7	0.7
Total, change in debt subject to statutory limitation	576.2	726.7	647.0	593.6	592.1	613.8	633.7
Debt Subject to Statutory Limitation, End of Year:							
Debt issued by Treasury	6,732.8	7,459.5	8,106.5	8,700.1	9,292.2	9,906.0	10,539.7
Adjustment for Treasury debt not subject to limitation and agency debt subject to limitation	–0.3	–0.3	–0.3	–0.3	–0.3	–0.3	–0.3
Adjustment for discount and premium [4]	5.1	5.1	5.1	5.1	5.1	5.1	5.1
Total, debt subject to statutory limitation [5]	6,737.6	7,464.4	8,111.4	8,705.0	9,297.0	9,910.9	10,544.6
Debt Outstanding, End of Year:							
Gross Federal debt: [6]							
Debt issued by Treasury	6,732.8	7,459.5	8,106.5	8,700.1	9,292.2	9,906.0	10,539.7
Debt issued by other agencies	27.2	27.0	26.5	26.3	25.7	25.1	24.4
Total, gross Federal debt	6,760.0	7,486.4	8,132.9	8,726.4	9,317.9	9,931.1	10,564.1
Held by:							
Debt held by Government accounts	2,846.4	3,065.7	3,341.1	3,652.2	3,984.8	4,341.6	4,719.7
Debt held by the public [7]	3,913.6	4,420.8	4,791.9	5,074.1	5,333.0	5,589.4	5,844.4

* $50 million or less.

[1] A decrease in the Treasury operating cash balance or compensating balances (which are assets) would be a means of financing a deficit and therefore has a positive sign. An increase in checks outstanding (which is a liability) would also be a means of financing a deficit and therefore also has a positive sign.

[2] Compensating balances are non-interest bearing Treasury bank deposits that Treasury mainly uses to compensate banks for collecting tax and non-tax receipts under financial agency agreements. Most of the balances at the end of 2003 were required to be invested in nonmarketable Depositary Compensation Securities issued by the Treasury; the rest of the balances, and the entire amount in previous years, was invested in the way that the banks decide.

[3] Besides checks outstanding, includes accrued interest payable on Treasury debt, miscellaneous liability accounts, allocations of special drawing rights; and, as an offset, cash and monetary assets (other than the Treasury operating cash balance and compensating balances), miscellaneous asset accounts, and profit on sale of gold.

[4] Consists of unamortized discount (less premium) on public issues of Treasury notes and bonds (other than zero-coupon bonds) and unrealized discount on Government account series securities.

[5] The statutory debt limit is $7,384 billion.

[6] Treasury securities held by the public and zero-coupon bonds held by Government accounts are almost all measured at sales price plus amortized discount or less amortized premium. Agency debt securities are almost all measured at face value. Treasury securities in the Government account series are otherwise measured at face value less unrealized discount (if any).

[7] At the end of 2003, the Federal Reserve Banks held $656.1 billion of Federal securities and the rest of the public held $3,257.5 billion. Debt held by the Federal Reserve Banks is not estimated for future years.

general fund to the fund that holds the securities and are a mechanism for that fund to accumulate interest on its balances. These accounting balances generally provide the fund with authority to draw upon the U.S. Treasury in later years to make future payments on its behalf to the public. Public policy may run surpluses and accumulate debt in trust funds and other Government accounts in anticipation of future spending.

However, issuing debt to Government accounts does not have any of the economic effects of borrowing from the public. It is an internal transaction of the Government, made between two accounts that are both within the Government itself. It is not a current transaction of the Government with the public; it is not financed by private saving and does not compete with the private sector for available funds in the credit market; it does not provide the account with resources other than a legal claim on the U.S. Treasury, which itself obtains real resources by taxation and borrowing; and its current interest does not have to be financed by taxes or other means.

Furthermore, the debt held by Government accounts does not represent the estimated amount of the account's obligations or responsibilities to make future payments to the public. For example, if the account records the transactions of a social insurance program, the debt that it holds does not represent the actuarial present value of estimated future benefits (or future benefits less taxes) for the current participants in the program; nor does it represent the actuarial present value of estimated future benefits (or future benefits less taxes) for the current participants plus the estimated future participants over some stated time period. The future transactions of Federal social insurance and employee retirement programs, which own 92 percent of the debt held by Government accounts, are important in their own right and need to be analyzed separately. This can be done through information published in the actuarial and financial reports for these programs.[4]

This budget uses a variety of information sources to analyze the condition of Social Security and Medicare, the Government's two largest social insurance programs. Chapter 12 of the present volume, "Stewardship," projects Social Security and Medicare outlays to 2080 relative to GDP. It also discusses in some detail the actuarial projections prepared for the Social Security and Medicare trustees reports to evaluate the long-run actuarial deficiency or shortfall in these programs. A chapter in the main volume of the budget, "Ensuring Fiscal Responsibility," uses the same data in less detail to explain the long-run fiscal problems of Social Security and Medicare revealed by these projections. The actuarial shortfalls are very different in concept and much larger in size than the amount of Treasury debt that these programs hold.

For all these reasons, debt held by the public is a better concept than gross Federal debt for analyzing the effect of the budget on the economy.

Debt securities do not encompass all the liabilities of the Federal Government. For example, accounts payable occur in the normal course of buying goods and services; Social Security benefits are due and payable as of the end of the month but, according to statute, are paid during the next month; loan guarantee liabilities are incurred when the Government guarantees the payment of interest and principal on private loans; and liabilities for future pension and retiree health payments are incurred as part of the current compensation for the services performed by Federal civilian and military employees in producing Government outputs. Like debt securities sold in the credit market, these liabilities have their own distinctive effects on the economy. Federal liabilities are analyzed within the broader conceptual framework of Federal resources and responsibilities in chapter 12 of this volume, "Stewardship." The different types of liabilities are reported annually in the financial statements of Federal agencies and in the *Financial Report of the United States Government,* prepared by the Treasury Department.

Government Surpluses or Deficits and the Change in Debt

Table 13–2 summarizes Federal borrowing and debt from 2003 through 2009. In 2003 the Government borrowed $373 billion, so the debt held by the public increased to $3,914 billion. The debt held by Government accounts increased $188 billion, and gross Federal debt increased by $562 billion to $6,760 billion.

Debt held by the public. The Federal Government primarily finances deficits by borrowing from the public, and it primarily uses surpluses to repay debt held by the public. Table 13–2 shows the relationship between the Federal deficit or surplus and the change in debt held by the public. The borrowing or debt repayment depends on the Federal Government's expenditure programs and tax laws, on the economic conditions that influence tax receipts and outlays, and on debt management policy. The sensitivity of the budget to economic conditions is analyzed in chapter 11 of this volume, "Economic Assumptions."

The total or unified budget surplus consists of two parts: the on-budget surplus or deficit; and the surplus of the off-budget Federal entities, which have been excluded from the budget by law. Under present law, the off-budget Federal entities are the Social Security trust funds (Old-Age and Survivors Insurance and Disability Insurance) and the Postal Service fund.[5] The off-budget totals are virtually the same as Social Security, which had a large surplus in 2003 and is estimated to have large and growing surpluses throughout the projection period. The on-budget and off-budget surpluses or deficits are added together to determine the Government's financing needs.

The Government's need to borrow, or its ability to repay debt held by the public, has always depended on several other factors besides the unified budget surplus or deficit, such as the change in the Treasury operating cash balance. As shown in table 15–2, these other factors which in this table are called "financing other than the change in debt held by the public" can either increase or decrease the Government's need to borrow. (An increase in its need to borrow is represented by a negative sign, like the deficit.) Some of these individual factors themselves may be either positive or negative, and some of them vary considerably in size from year to year. In 2003 the deficit was $375 billion and the "financing other than the change in debt held by the public" was $2 billion. As a result, the Government borrowed $373 billion from the public.

Over the long-run, it is a good approximation to say that "the deficit is financed by borrowing from the public" or "the surplus is used to repay debt held by the

[4] Extensive actuarial analyses of the Social Security and Medicare programs are published in the annual reports of the boards of trustees of these funds. Annual actuarial reports are also prepared for major Federal employee retirement funds. The actuarial estimates for these and other programs are summarized in the *Financial Report of the United States Government,* prepared annually by the Treasury Department.

[5] For further explanation of the off-budget Federal entities, see chapter 22, "Off-Budget Federal Entities and Non-Budgetary Activities."

public." Over the last 20 years, the cumulative deficit was $2,584 billion and the increase in debt held by the public was $2,776 billion. The other factors added a total of $192 billion of borrowing, an average of $10 billion per year. The variation was wide, ranging from additional borrowing (or lower repayment) of $63 billion to reduced borrowing of $19 billion.

In individual years it is often a good approximation to say that the deficit and borrowing (or the surplus and debt repayment) are about the same. In 2003, as shown in table 15–2, the difference was only $2 billion. However, a combination of events may produce a relatively large total for the other factors in a particular year. In 2002, for example, several of the other factors were large, and all added to the need for borrowing. In combination, they accounted for $63 billion of the $221 billion increase in debt held by the public, which was an exceptionally large proportion. Four specific factors have recently been especially important.

Change in Treasury operating cash balance.—The operating cash balance decreased $26 billion during 2003, partly because it was higher than planned at the end of the previous year. It is estimated to be essentially the same at the end of 2004. Changes in the operating cash balance, while occasionally large, are inherently limited. Decreases in cash—a means of financing the Government—are limited by the amount of past accumulations, which themselves required financing when they were built up. Increases are limited because it is more efficient to repay debt.

Change in compensating balances.—Treasury has long used compensating balances to compensate banks for collecting tax and non-tax receipts and providing other services under financial agency agreements. Under these agreements, Treasury deposited a non-interest bearing compensating balance with a bank. The imputed earnings from the compensating balance, calculated at the 91-day Treasury bill rate, were the source of the bank's compensation for performing the required services. Treasury determined the size of the deposit by balancing the value of the services provided with the imputed earnings of the compensating balance. Banks could use the compensating balances on deposit to make loans or buy investments, and all compensating balances were fully collateralized.

The traditional compensating balances presented difficulties for cash and debt management in recent years. First, any decrease in the interest rate that was applied to compensating balances required Treasury to increase the size of compensating balances on deposit to pay for the services it needed. For example, because interest rates decreased so much during 2002, Treasury had to increase its compensating balances by $14 billion in that year. Second, when the debt outstanding reached the statutory debt limit, Treasury had to draw down the compensating balances and then make up for this action afterwards by increasing the balances to unusually high levels. These actions were inefficient and disruptive, and they created financial uncertainty for Treasury and the banks.

In large part because of these difficulties, the 2004 budget proposed legislation that would allow Treasury to replace compensating balances by a permanent indefinite appropriation to pay banks directly for their services as depositaries and financial agents. This also would simplify Treasury's cash and debt management, would ensure that payments to financial institutions for services were made in a more predictable manner, and could result in budget savings.

As an interim step, before the legislation could be enacted, Treasury began to replace its traditional compensating balances with depositary compensation securities (DCS) in July 2003. The banks hold DCS instead of other acceptable investments, and the Treasury balances are secured by the DCS. The cost of the services provided to Treasury is part of the interest on the debt under either system. Under the traditional system, Treasury paid interest to the general public on the marketable securities sold to acquire the compensating balances; under the interim system, Treasury pays interest to banks on the DCS. By the end of December 2003, the traditional compensating balances had been replaced by DCS.

Congress authorized a permanent indefinite appropriation to pay for the services in October 2003 in the Check Clearing for the 21st Century Act (P.L. 108–100). An appropriation is included in the conference version of the Omnibus Appropriation bill for 2004. At such time as this bill is enacted, Treasury plans to replace the DCS by direct payments as soon as practicable. The total compensating balances at the end of 2003 under both systems were $22 billion, and table 15–2 estimates that they will be drawn down to zero during 2004.

Net purchases of non-Federal securities by the National Railroad Retirement Investment Trust.—This trust fund was established by the Railroad Retirement and Survivors' Improvement Act of 2001. Most of the assets in the Railroad Retirement Board trust funds were transferred to the new trust fund in 2003, which invests its assets primarily in private stocks and bonds. The Act ordered special treatment of the purchase or sale of non-Federal assets by this trust fund, treating such purchases as a means of financing rather than an outlay. Therefore, the increased need to borrow from the public to finance the purchase of non-Federal assets is part of the "financing other than the change in debt held by the public" rather than included as an increase in the deficit. This increased borrowing and publicly held debt by $20 billion in 2003. Net purchases or sales in subsequent years are estimated to be relatively small.[6]

Net financing disbursements of the direct loan and guaranteed loan financing accounts.—The financing accounts were created by the Federal Credit Reform Act of 1990. Budget outlays for direct loans and loan guarantees consist of the estimated subsidy cost of the loans or guarantees at the time when the direct loans or

[6] The budget treatment of this fund is further discussed in chapter 25, "The Budget System and Concepts."

guaranteed loans are disbursed. The cash flows to and from the public resulting from these loans and guarantees—the disbursement and repayment of loans, the default payments on loan guarantees, the collections of interest and fees, and so forth—are not costs to the Government except for those costs already included in budget outlays. Therefore, they are non-budgetary in nature and are recorded as transactions of the non-budgetary financing account for each credit program.[7]

The financing accounts also include intra-governmental transactions. In particular, they receive payment from the credit program accounts for the costs of new direct loans and loan guarantees. These collections are offset against the gross disbursements of the financing accounts in determining the accounts' total net cash flows. The total net cash flows of the financing accounts, consisting of transactions with both the public and the budgetary accounts, are called "net financing disbursements." They are defined in the same way as the "outlays" of a budgetary account and therefore affect the requirement for borrowing from the public in the same way as the deficit.

The result is that the intragovernmental transactions of the financing accounts do not affect Federal borrowing from the public. Although the deficit changes because of the budget's outlay or receipt, the net financing disbursement changes in an equal amount with the opposite sign, so the effects cancel out. On the other hand, financing account disbursements to the public increase the requirement for borrowing from the public in the same way as an increase in budget outlays that are disbursed to the public in cash. Likewise, financing account receipts from the public can be used to finance the payment of the Government's obligations, and therefore they reduce the requirement for Federal borrowing from the public in the same way as an increase in budget receipts.

The impact of the financing accounts became large in the mid-1990s. In 2003 they required $7 billion of financing, which increased borrowing by this amount. They are estimated to require additional financing of $8 billion in 2005 and from $15 billion to $19 billion in each of the following four years. A major part is normally due to the direct student loan program. Since direct loans require cash disbursements equal to the full amount of the loans when the loans are made, Federal borrowing requirements are initially increased. Later, when the loans are repaid, Federal borrowing requirements will decrease.

Debt held by Government accounts.—The amount of Federal debt issued to Government accounts depends largely on the surpluses of the trust funds, both on-budget and off-budget, which owned 95 percent of the total Federal debt held by Government accounts at the end of 2003. In 2003, for example, the total trust fund surplus was $178 billion, and Government accounts invested $188 billion in Federal securities. A major reason for the larger investment is that some special funds and revolving funds, as well as the trust funds, invest in Federal debt. This was partially offset because, as explained above, the National Railroad Retirement Investment Trust invested $20 billion in non-Federal assets. This offset is expected to be relatively minor in the future. Another factor is that the trust funds may change the amount of their cash assets not currently invested. The debt held in major accounts and the annual investments are shown in table 15–4.

Agency Debt

Several Federal agencies, shown in table 15–3, sell debt securities to the public and at times in the past have sold securities to other Government accounts. During 2003, agencies repaid $0.2 billion of debt held by the public. Agency debt is less than one percent of Federal debt held by the public. Agencies are estimated to repay small amounts of debt in 2004 and 2005.

The reasons for issuing agency debt differ considerably from one agency to another. The predominant agency borrower is the Tennessee Valley Authority, which had borrowed $26 billion from the public as of the end of 2003, or 96 percent of the total debt of all agencies. In some earlier periods, other agencies accounted for a much higher proportion of agency debt than they do now. TVA sells debt primarily to finance capital expenditures.

The Federal Housing Administration, on the other hand, has for many years issued both checks and debentures as means of paying claims to the public that arise from defaults on FHA-insured mortgages. Issuing debentures to pay the Government's bills is equivalent to selling securities to the public and then paying the bills by disbursing the cash borrowed, so the transaction is recorded as being simultaneously an outlay and a borrowing. The debentures are therefore classified as agency debt. The borrowing by FHA and a few other agencies that have engaged in similar transactions is thus inherent in the way that their programs operate.[8]

Some types of lease-purchase contracts are equivalent to direct Federal construction financed by Federal borrowing. A number of years ago, the Federal Government guaranteed the debt used to finance the construction of buildings for the National Archives and the Architect of the Capitol, and subsequently exercised full control over the design, construction, and operation of the buildings. The construction expenditures and interest were therefore classified as Federal outlays, and the borrowing was classified as Federal agency borrowing from the public.

The proper budgetary treatment of lease-purchases was further examined in connection with the Budget

[7] The Federal Credit Reform Act of 1990 (sec. 505(b)) requires that the financing accounts be non-budgetary. As explained in chapter 22, "Off-Budget Federal Entities and Non-Budgetary Activities," they are non-budgetary in concept because they do not measure cost. For additional discussion of credit reform, see chapter 25 of this volume, "The Budget System and Concepts," and the other references cited in chapter 22.

[8] For an explanation of the monetary credits issued by the Federal Communications Commission (FCC), see chapter 25 of this volume, "The Budget System and Concepts." The budgetary treatment of some of these securities and other securities inherent in the way programs operate is further explained in Special Analysis E of the 1989 Budget, pp. E–25 to E–26; and Special Analysis E of the 1988 Budget, pp. E–27 to E–28.

Table 15–3. AGENCY DEBT

(In millions of dollars)

	Borrowing or repayment (–) of debt			Debt end of 2005 estimate
	2003 actual	2004 estimate	2005 estimate	
Borrowing from the public:				
Housing and Urban Development:				
Federal Housing Administration	–19	....	....	279
Small Business Administration:				
Participation certificates: Section 505 development company	....	....	....	7
Architect of the Capitol	–3	–3	–3	160
Farm Credit System Financial Assistance Corporation	–450	....	–325	....
Federal Communications Commission	–59	–56	....	....
National Archives	–7	–8	–8	235
Tennessee Valley Authority:				
Bonds and Notes	–385	–1,621	–65	23,190
Lease/leaseback obligations	677	–69	–35	1,134
Prepayment obligations	47	1,469	–66	1,450
Total, borrowing from the public	–198	–288	–502	26,455
Total, agency borrowing	–198	–288	–502	26,455

Enforcement Act of 1990. Several changes were made. Among other decisions, it was determined that outlays for a lease-purchase without substantial private risk will be recorded in an amount equal to the asset cost over the period during which the contractor constructs, manufactures, or purchases the asset; if the asset already exists, the outlays will be recorded when the contract is signed. Agency borrowing will be recorded each year to the extent of these outlays. The agency debt will subsequently be redeemed over the lease payment period by a portion of the annual lease payments according to an amortization schedule. This rule was effective starting in 1991.[9] The new budgetary treatment was reviewed in connection with the Balanced Budget Act of 1997. Some clarifications were made, but no substantive changes.

The Tennessee Valley Authority has traditionally financed its capital construction by selling bonds and notes to the public. Starting in 2000, it has also employed two types of alternative financing methods. The first type of alternative financing method was lease/leasebacks. TVA signed contracts to lease some recently constructed power generators to private investors and simultaneously lease them back. It received a lump sum for leasing out its assets, and then leased them back at fixed annual payments for a set number of years. TVA retains substantially all of the economic benefits and risks related to ownership of the assets, and the lease/leasebacks are reported as liabilities on TVA's balance sheet under generally accepted accounting principles.

The Office of Management and Budget determined that the TVA lease/leasebacks are a means of financing the acquisition of assets owned and used by the Government. The arrangement is at least as governmental as a "lease-purchase without substantial private risk." The budget therefore records the upfront cash proceeds from the lease as borrowing from the public, not offsetting collections. Agency debt in the form of a lease obligation is recorded as a type of borrowing. The same budget treatment was applied to the lease/leaseback of qualified technological equipment in 2003. The total amount of the lease obligations beginning in 2000 is shown in table 15–3 separately from TVA bonds and notes to distinguish between the types of borrowing. The obligations for lease/leasebacks increased to $1.2 billion at the end of 2003 and are estimated to decline steadily in the following years as they are amortized.

The second type of alternative financing method is prepayments for power that TVA sells to its power distributors. Under the Discounted Energy Units program, which began in 2003, distributors may prepay a portion of the price of the power they plan to purchase in the future. In return, they obtain a discount on a specific quantity of the future power they buy from TVA. The quantity varies, depending on TVA's estimated cost of borrowing. Most of the prepayments have been relatively small. However, TVA has entered into a contract with Memphis Light, Gas, and Water, under which that distributor will prepay $1.5 billion for a large portion of its power needs over the next 15 years in return for a discount on that power. The distributor, in turn, will finance its prepayment by selling tax-exempt bonds.

The Office of Management and Budget has determined that these prepayments are also a means of financing the acquisition of assets owned and used by the Federal Government, or, in effect, are used to refinance debt previously incurred to finance such assets. They are equivalent in concept to other forms of borrowing from the public, although at different terms and conditions. The prepayment obligations are recorded as liabilities, called "unearned revenue," on TVA's balance sheet under generally accepted accounting principles. The budget therefore records the upfront cash proceeds from the prepayment as borrowing from the public, not

[9] The rule addressed all lease-purchases and capital leases from the public, not just those without substantial private risk. For all such contracts, the rule requires that budget authority be recorded up front for the present value of the lease payments. See OMB Circular No. A–11, Appendix B. Also see the section on outlays in chapter 25, "The Budget System and Concepts."

offsetting collections. Agency debt in the form of a prepayment obligation is recorded as a type of borrowing. The total amount of prepayment obligations is shown in table 15–3 separately from bonds and notes and lease/leaseback obligations to distinguish between these types of borrowing. The prepayment obligations increased from zero to $47 million during 2003 and are estimated to be $1.5 billion at the end of 2004 because of the contract with Memphis Light, Gas, and Water. The obligations are estimated to decline steadily in the following years as they are amortized.

The amount of agency securities sold to the public has been reduced by borrowing from the Federal Financing Bank (FFB). The FFB is an entity within the Treasury Department, one of whose purposes is to substitute Treasury borrowing for agency borrowing from the public. It has the authority to purchase agency debt and finance these purchases by borrowing from the Treasury. Agency borrowing from the FFB is not included in gross Federal debt. It would be double counting to add together (a) the agency borrowing from the FFB and (b) the Treasury borrowing from the public that was needed to provide the FFB with the funds to lend to the agencies.

Debt Held by Government Accounts

Trust funds, and some special funds and public enterprise revolving funds, accumulate cash in excess of current needs in order to meet future obligations. These cash surpluses are generally invested in Treasury debt.

Table 15–4. DEBT HELD BY GOVERNMENT ACCOUNTS [1]

(In millions of dollars)

Description	Investment or Disinvestment (–)			Holdings end of 2005 estimate
	2003 actual	2004 estimate	2005 estimate	
Investment in Treasury debt:				
Energy:				
Nuclear waste disposal fund [1]	1,041	1,786	1,752	17,729
Uranium enrichment decontamination fund	423	380	406	4,196
Health and Human Services:				
Federal hospital insurance trust fund	22,401	9,381	10,633	271,321
Federal supplementary medical insurance trust fund	–13,956	–3,557	7,748	29,040
Vaccine Injury compensation fund	138	398	166	2,460
Housing and Urban Development:				
Federal Housing Administration mutual mortgage fund	2,571	....	4,000	27,819
Other HUD	285	257	283	7,785
Interior: Abandoned Mine Reclamation fund	32	114	7	2,048
Labor:				
Unemployment trust fund	–20,076	–6,377	4,255	46,066
Pension Benefit Guaranty Corporation [1]	–279	776	–636	12,356
State: Foreign Service retirement and disability trust fund	555	567	650	13,506
Transportation:				
Highway trust fund	–5,263	1,712	1,385	16,675
Airport and airway trust fund	–479	864	–1,426	9,956
Homeland Security				
Oil spill liability trust fund	–48	–122	–71	762
Aquatic resources trust fund	46	–110	....	1,306
Treasury: Exchange stabilization fund	785	211	....	10,713
Veterans Affairs:				
National service life insurance trust fund	–219	–299	–359	10,588
Other trust funds	53	24	17	2,009
Federal funds	–13	–23	–20	454
Defense-Civil:				
Uniformed Services Retiree Health Care Fund	18,445	20,059	23,833	62,337
Military retirement trust fund	9,966	9,661	7,950	189,973
Harbor maintenance trust fund	139	–110	....	1,833
Environmental Protection Agency:				
Hazardous substance trust fund	–726	292	–81	2,719
Leaking underground storage tank trust fund	145	197	201	2,436
International Assistance Programs:				
Overseas Private Investment Corporation	194	103	200	3,961
Office of Personnel Management:				
Civil Service retirement and disability trust fund	27,996	29,838	31,121	662,668
Employees life insurance fund	1,428	971	1,573	29,322
Employees health benefits fund	1,482	1,044	1,022	11,103
Social Security Administration:				
Federal old-age and survivors insurance trust fund [2]	139,668	138,044	166,977	1,618,448
Federal disability insurance trust fund [2]	15,506	11,352	12,133	194,278
Farm Credit System Insurance Corporation:				
Farm Credit System Insurance fund	124	185	–71	1,924
Federal Deposit Insurance Corporation:				
Bank Insurance fund	513	2,163	404	33,621
FSLIC Resolution fund	163	347	....	3,310

Table 15–4. DEBT HELD BY GOVERNMENT ACCOUNTS [1]—Continued

(In millions of dollars)

Description	Investment or Disinvestment (–)			Holdings end of 2005 estimate
	2003 actual	2004 estimate	2005 estimate	
Savings Association Insurance fund	270	963	451	12,837
National Credit Union Administration: Share insurance fund	558	446	484	6,637
Postal Service fund [2]	1,221	–1,251	....	1,400
Railroad Retirement Board trust funds [1]	–17,740	171	–17	2,471
Other Federal funds [3]	1,232	–95	747	9,508
Other trust funds	–398	–1,108	–293	5,151
Unrealized discount [1]	218	....	....	–1,643
Total, investment in Treasury debt [1]	**188,401**	**219,252**	**275,424**	**3,341,083**
Total, investment in Federal debt [1]	**188,401**	**219,252**	**275,424**	**3,341,083**
MEMORANDUM				
Investment by Federal funds (on-budget)	26,343	27,670	31,840	217,235
Investment by Federal funds (off-budget)	1,221	–1,251	....	1,400
Investment by trust funds (on-budget)	5,445	43,436	64,474	1,311,365
Investment by trust funds (off-budget)	155,174	149,397	179,110	1,812,726
Unrealized discount [1]	218	....	....	–1,643

[1] Debt held by Government accounts is measured at face value except for the Treasury zero-coupon bonds held by the Nuclear Waste Disposal fund, the Pension Benefit Guaranty Corporation (PBGC), and the Railroad Retirement Board (Rail Industry Pension Fund), which are recorded at market or redemption price; and the unrealized discount on Government account series, which is not distributed by account. Changes are not estimated in the unrealized discount. If recorded at face value, the debt held by the Nuclear Waste Disposal fund would be $11.7 billion higher than recorded in this table at the end of 2003; the debt held by PBGC would be $0.7 billion higher.

[2] Off-budget Federal entity.

[3] Retroactively includes debt held by the Telecommunications Development Fund as of the end of 2002. Debt held by Government accounts was increased by $32 million at the end of 2002 and 2003, and debt held by the public was decreased by identical amounts.

Investment by trust funds and other Government accounts has risen greatly for many years. It was $188 billion in 2003, as shown in table 15–4, and is estimated to be $275 billion in 2005. The holdings of Federal securities by Government accounts are estimated to grow to $3,341 billion by the end of 2005, or 41 percent of the gross Federal debt. This percentage is estimated to rise gradually in the following years, as the trust funds and several major Federal funds continue to accumulate surpluses.

The large investment by Government accounts is concentrated among a few trust funds. The two Social Security trust funds—Old-Age and Survivors Insurance and Disability Insurance—have a large combined surplus and invest $484 billion during 2003–05, which is 71 percent of the total estimated investment by Government accounts. The two Medicare trust funds—Hospital Insurance and Supplementary Medical Insurance—account for another 5 percent of the total estimated investment.

Apart from these four social insurance funds, the largest investment is by the funds for Federal employee retirement. The principal trust fund for Federal civilian employees is the civil service retirement and disability trust fund, which accounts for 13 percent of the total investment by Government accounts during 2003–05. The military retirement trust fund and the special fund for uniformed services retiree health care account for another 13 percent. Altogether, the investment by Social Security, Medicare, and these three Federal employee retirement funds is more than the total investment by Government accounts during this period. At the end of 2005, they are estimated to own 91 percent of the total debt held by Government accounts.

Many of the other Government accounts also increase their holdings of Federal securities during this period, but three accounts record major decreases. The unemployment trust fund disinvested $20 billion last year and is estimated to disinvest $6 billion this year, as the result of the recession and the initially slow recovery. The previously existing trust funds under the Railroad Retirement Board, which were invested in Treasury securities, transferred most of their assets to the National Railroad Retirement Investment Trust, which invested mainly in private stocks and bonds (see previous discussion). The effect in 2003 was a net disinvestment of $18 billion for the Railroad Retirement Board as a whole. The Supplementary Medical Insurance trust fund is estimated to disinvest $18 billion in 2003–04, after which it accumulates assets again.

Technical note on measurement.—The Treasury securities held by Government accounts consist almost entirely of the Government account series. Most were issued at par value (face value), and the securities issued at a discount or premium were traditionally recorded at par in the OMB and Treasury reports on Federal debt. However, there are two kinds of exceptions. First, in 1991, Treasury began to issue zero-coupon bonds to a very few Government accounts. Because the purchase price is a small fraction of par value and the amounts are large, the holdings are recorded in table 13–4 at par value less unamortized discount. The only three Government accounts that held zero-coupon bonds during the period of this table are the Nuclear Waste Disposal fund in the Department of Energy, the Pension Benefit Guaranty Corporation (PBGC), and the Rail Industry Pension fund under the Railroad Retirement Board. The Rail Industry Pension fund disinvested them in 2003 as it transferred assets to the National Railroad Retirement Investment Trust as discussed above. The total unamortized discount on zero-coupon bonds was $12.4 billion at the end of 2003.

Second, in September 1993 Treasury began to subtract the unrealized discount on other Government account series securities in calculating "net federal securities held as investments of government accounts." Unlike the discount recorded for zero-coupon bonds and debt held by the public, the unrealized discount is the discount at the time of issue and is not amortized over the term of the security. In table 15–4 it is shown as a separate item at the end of the table and not distributed by account. The amount was $1.6 billion at the end of 2003.

Limitations on Federal Debt

Definition of debt subject to limit.—Statutory limitations have usually been placed on Federal debt. Until World War I, the Congress ordinarily authorized a specific amount of debt for each separate issue. Beginning with the Second Liberty Bond Act of 1917, however, the nature of the limitation was modified in several steps until it developed into a ceiling on the total amount of most Federal debt outstanding. This last type of limitation has been in effect since 1941. The limit currently applies to most debt issued by the Treasury since September 1917, whether held by the public or by Government accounts; and other debt issued by Federal agencies that, according to explicit statute, is guaranteed as to principal and interest by the United States Government.

The third part of table 15–2 compares total Treasury debt with the amount of Federal debt that is subject to the limit. Nearly all Treasury debt is subject to the debt limit. The only existing Treasury debt not subject to limit is mostly silver certificates and other currencies no longer being issued. The Federal Financing Bank (FFB), which is within the Treasury Department, is authorized to have outstanding up to $15 billion of publicly issued debt, and this debt is not subject to the general limit. This amount was issued several years ago to the Civil Service Retirement and Disability fund, redeemed in early 2003, and then issued again for a few months later in 2003 when the debt subject to limit reached the statutory ceiling (for further discussion, see below). It was redeemed before the end of 2003 and is estimated to remain zero.

The sole type of agency debt currently subject to the general limit is the debentures issued by the Federal Housing Administration, which was only $265 million at the end of 2003. Some of the other agency debt, however, is subject to its own statutory limit. For example, the Tennessee Valley Authority is limited to $30 billion of debt outstanding.

The comparison between Treasury debt and debt subject to limit also includes an adjustment for measurement differences in the treatment of discounts and premiums. As explained elsewhere in this chapter, debt securities may be sold at a discount or premium, and the measurement of debt may take this into account rather than recording the face value of the securities. However, the measurement differs between gross Federal debt (and its components) and the statutory definition of debt subject to limit. An adjustment is needed to derive debt subject to limit (as defined by law) from Treasury debt, and this adjustment is defined in footnote 6 to table 15–2. The amount is relatively small: $5.1 billion at the end of 2003 compared to the total unamortized discount (less premium) of $50.6 billion on all Treasury securities.

Changes in the debt limit.—The statutory debt limit has been changed many times. Since 1960, Congress has passed 70 separate acts to raise the limit, extend the duration of a temporary increase, or revise the definition. For a long period up to 1990, the debt limit was also changed frequently. Since then, however, the debt limit has been increased three times by amounts large enough to last for two years or more. All three of these increases were enacted as part of a deficit reduction package or a plan to balance the budget and were intended to last a relatively long time: the Omnibus Budget Reconciliation Act of 1990, the Omnibus Budget Reconciliation Act of 1993, and the Balanced Budget Act of 1997.[10]

The Balanced Budget Act of 1997 increased the debt limit to $5,950 billion, which lasted until 2002. The debt reached the limit in April 2002, the Treasury Department took a variety of administrative actions to keep within the limit, and on June 28 the President signed a bill to raise the limit to $6,400 billion.

This limit did not last quite one year. By December 2002, Treasury wrote Congress that the debt subject to limit might reach the ceiling in the latter half of February 2003. It did run up against the limit on February 20 and stayed there until the limit was increased.

Treasury took several steps at the start to meet the Government's obligation to pay its bills and invest its trust funds while keeping debt under the statutory limit. The Secretary of Treasury declared that he would not be able to fully invest the Government Securities Investment Fund (G-fund). This fund is one component of the Thrift Savings Fund, a defined contribution pension plan for Federal employees. The Secretary has statutory authority to suspend investment of the G-fund in Treasury securities as needed to prevent the debt from exceeding the debt limit; when he does this, he is required to make the fund whole after the debt limit has been raised by restoring the lost interest and investing the fund fully. Starting on February 20,

[10] The Acts and the statutory limits since 1940 are enumerated in *Historical Tables, Budget of the United States Government,* table 7.3.

Table 15–5. FEDERAL FUNDS FINANCING AND CHANGE IN DEBT SUBJECT TO STATUTORY LIMIT

(In billions of dollars)

Description	2003 Actual	Estimate					
		2004	2005	2006	2007	2008	2009
Federal funds deficit (–)	–553.7	–708.6	–606.9	–546.6	–537.1	–559.3	–575.2
Means of financing other than borrowing:							
Change in: [1]							
Treasury operating cash balances	25.9	–*	....	....	....	....	....
Compensating balances [2]	–5.2	22.2	....	....	....	....	....
Checks outstanding, etc [3]	5.8	–5.7	–0.1	0.1	0.3	0.3	0.5
Seignorage on coins	0.6	0.6	0.7	0.7	0.7	0.7	0.7
Less: Net financing disbursements:							
Direct loan financing accounts	–6.5	–11.8	–11.5	–18.8	–20.1	–20.3	–20.7
Guaranteed loan financing accounts	–0.7	3.3	3.2	3.4	1.5	1.8	1.6
Total, means of financing other than borrowing	19.9	8.6	–7.8	–14.6	–17.6	–17.4	–17.9
Decrease or increase (–) in Federal debt held by Federal funds	–27.6	–26.4	–31.8	–32.2	–36.8	–36.4	–39.9
Increase or decrease (–) in Federal debt not subject to limit	–15.2	–0.3	–0.5	–0.2	–0.5	–0.7	–0.7
Total, requirement for Federal funds borrowing subject to debt limit	576.6	726.7	647.0	593.6	592.1	613.8	633.7
Change in discount and premium [4]	–0.6	....	....	....	....	....	....
Change in unrealized discount [5]	0.2	....	....	....	....	....	....
Increase in debt subject to limit	576.2	726.7	647.0	593.6	592.1	613.8	633.7
ADDENDUM							
Debt subject to statutory limit [6]	6,737.6	7,464.4	8,111.4	8,705.0	9,297.0	9,910.9	10,544.6

* $50 million or less.

[1] A decrease in the Treasury operating cash balance or compensating balances (which are assets) would be a means of financing the deficit and therefore has a positive sign. An Increase in checks outstanding (which is a liability) would also be a means of financing the deficit and would therefore also have a positive sign.

[2] Compensating balances are non-interest bearing Treasury bank deposits that Treasury mainly uses to compensate banks for collecting tax and non-tax receipts under financial agency agreements. Most of the balances at the end of 2003 were frequired to be invested in nonmarketable Depositary Compensation Securities issued by the Treasury; the rest of the balances, and the entire amount in previous years, was invested in the way that the banks decide.

[3] Besides checks outstanding, includes accrued interest payable on Treasury debt, miscellaneous liability accounts, allocations of special drawing rights; and, as an offset, cash and monetary assets (other than the Treasury operating cash balance and compensating balances), miscellaneous asset accounts, and profit on the sale of gold.

[4] Consists of unamortized discount (less premium) on public issues of Treasury notes and bonds (other than zero-coupon bonds) and unrealized discount on Government account series securities.

[5] The unrealized discount is for Government account series securities

[6] The statutory debt limit is $7,384 billion.

Treasury determined each day the amount of investments that would allow the fund to be invested as fully as possible without exceeding the debt limit. In addition to this step, Treasury also began to keep its operating cash balances lower than in the absence of a debt limit problem; reduced its compensating balances held in banks to pay for services under financial agency agreements; and discontinued the acceptance of subscriptions to the state and local government series of securities.

As the need for financing grew, Treasury took further steps. In early March, Treasury issued $15 billion of Federal Financing Bank (FFB) securities to the Civil Service Retirement and Disability fund in exchange for an equivalent amount of regular Treasury securities, which it redeemed. As explained above, the FFB securities are not subject to the debt limit. At the end of March, Treasury began to disinvest the Exchange Stabilization fund to the extent needed. In April, the Secretary declared a debt issuance suspension period, under which he could redeem a limited amount of securities held by the Civil Service Retirement and Disability fund and stop investing its receipts. He declared an extension of the debt issuance suspension period in May, which allowed him to redeem more securities. All the steps taken during these months had also been taken on previous occasions when the debt had reached the statutory limit, and most of them had been taken in 2002.

Congress passed a bill raising the debt limit to $7,384 billion on May 23, when the Senate passed a House joint resolution based on the congressional budget resolution (see the next section). The President signed the bill on May 27, and Treasury promptly auctioned new securities in the credit market, restored the lost interest to the G-fund and Civil Service fund, and fully invested these funds and the Exchange Stabilization fund. The FFB securities held by the Civil Service fund were redeemed at the end of June in exchange for regular Treasury securities.

Methods of changing the debt limit.—The statutory limit is usually changed by normal legislative procedures. Under the rules adopted by the House of Representatives in January 2003, it can also be changed as a consequence of the annual Congressional budget resolution, which is not itself a law. The budget resolution includes a provision specifying the appropriate level of the debt subject to limit at the end of each fiscal year. The new rule provides that, when the budget resolution is adopted by both Houses of the Congress, the vote in the House of Representatives is deemed to have been a vote in favor of a joint resolution setting the statutory limit at the level specified in the budget resolution. The joint resolution is transmitted to the Senate for further action, where it may be amended to change the debt limit provision or in any other way. If it passes both Houses of the Congress, it is sent to the President for his signature.

The House of Representatives first adopted this rule for 1980 and it was used a number of times, but it was not included in the rules for several years before 2003.

Federal funds financing and the change in debt subject to limit.—The change in debt held by the public, as shown in table 15–2, is determined primarily by the total Government deficit or surplus. The debt subject to limit, however, includes not only debt held by the public but also debt held by Government accounts. The change in debt subject to limit is therefore determined both by the factors that determine the total Government deficit or surplus and by the factors that determine the change in debt held by Government accounts. The effect of debt held by Government accounts on the total debt subject to limit is brought out sharply in the second part of table 15–2. The change in debt held by Government accounts is a large proportion of the change in total debt subject to limit each year and accounts for half of the estimated total increase from 2003 through 2009.

The budget is composed of two groups of funds, Federal funds and trust funds. The Federal funds, in the main, are derived from tax receipts and borrowing and are used for the general purposes of the Government. The trust funds, on the other hand, are financed by taxes or other receipts earmarked by law for specified purposes, such as paying Social Security benefits or making grants to state governments for highway construction.[11]

A Federal funds deficit must generally be financed by borrowing, which can be done either by selling securities to the public or by issuing securities to Government accounts that are not within the Federal funds group. Federal funds borrowing consists almost entirely of Treasury securities that are subject to the statutory debt limit. Very little debt subject to statutory limit has been issued for reasons except to finance the Federal funds deficit. The change in debt subject to limit is therefore determined primarily by the Federal funds deficit, which is equal to the difference between the total Government surplus and the trust fund surplus. Trust fund surpluses are almost entirely invested in securities subject to the debt limit, and trust funds hold most of the debt held by Government accounts.

Table 15–5 derives the change in debt subject to limit. In 2003 the Federal funds deficit was $554 billion, and other factors increased the requirement to borrow subject to limit by $23 billion. The largest of these other factors was the $28 billion investment in Treasury securities by special funds and revolving funds, of which the largest single investment was $18 billion for the uniformed services retiree health care fund. The next largest factor was redeeming $15 billion of Federal Financing Bank securities, which were not subject to the debt limit and were replaced by securities that were subject to the limit. The net financing disbursements of the direct loan financing accounts added $6 billion to the financing requirements. As explained in an earlier section, the transactions of the credit financing accounts are excluded from the budget by law because they are not a cost to the Government, but they are sizable and have to be financed. As an offset, the Treasury operating cash balance deceased $26 billion. As a net result of all these factors, debt subject to limit increased by $576 billion, while debt held by the public increased by $373 billion.

The debt subject to limit is estimated to increase to $7,464 billion by the end of 2004, which is more than the present statutory debt limit of $7,384 billion. This is caused by a rise in the Federal funds deficit, supplemented by the other factors shown in table 15–5. Some of these factors are large, especially the investment by Federal special and revolving funds and in particular the special fund for uniformed services retiree health care. As a result, while debt held by the public increases by $1,931 billion during 2004–09, debt subject to limit increases by $3,807 billion.

Debt Held by Foreign Residents

During most of American history, the Federal debt was held almost entirely by individuals and institutions within the United States. In the late 1960s, as shown in table 15–6, foreign holdings were just over $10.0 billion, less than 5 percent of the total Federal debt held by the public.

Foreign holdings began to grow significantly starting in 1970. This increase has been almost entirely due to decisions by foreign central banks, corporations, and individuals, rather than the direct marketing of these securities to foreign residents. At the end of 2003 foreign holdings of Treasury debt were $1,459 billion, which was 37 percent of the total debt held by the public.[12] Foreign central banks owned 56 percent of the Federal debt held by foreign residents; private investors owned nearly all the rest. All the Federal debt held by foreign residents is denominated in dollars.

Although the amount of Federal debt held by foreign residents grew greatly over this period, the proportion

[11] For further discussion of the trust funds and Federal funds groups, see chapter 21, “Trust Funds and Federal Funds.”

[12] The amounts of debt reported by the Bureau of Economic Analysis, Department of Commerce, are different, though similar in size, because of a different method of valuing the securities.

Table 15–6. FOREIGN HOLDINGS OF FEDERAL DEBT

(Dollar amounts in billions)

Fiscal Year	Debt held by the public			Borrowing from the public	
	Total	Foreign [1]	Percentage foreign	Total [2]	Foreign [1]
1965	260.8	12.3	4.7	3.9	0.3
1966	263.7	11.6	4.4	2.9	–0.7
1967	266.6	11.4	4.3	2.9	–0.2
1968	289.5	10.7	3.7	22.9	–0.7
1969	278.1	10.3	3.7	–11.4	–0.4
1970	283.2	14.0	5.0	5.1	3.8
1971	303.0	31.8	10.5	19.8	17.8
1972	322.4	49.2	15.2	19.3	17.3
1973	340.9	59.4	17.4	18.5	10.3
1974	343.7	56.8	16.5	2.8	–2.6
1975	394.7	66.0	16.7	51.0	9.2
1976	477.4	69.8	14.6	82.7	3.8
TQ	495.5	74.6	15.1	18.1	4.9
1977	549.1	95.5	17.4	53.6	20.9
1978	607.1	121.0	19.9	58.0	25.4
1979 [3]	640.3	120.3	18.8	33.2	n.a
1980	711.9	121.7	17.1	71.6	1.4
1981	789.4	130.7	16.6	77.5	9.0
1982	924.6	140.6	15.2	135.2	9.9
1983	1,137.3	160.1	14.1	212.7	19.5
1984	1,307.0	175.5	13.4	169.7	15.4
1985 [3]	1,507.3	222.9	14.8	200.3	n.a
1986	1,740.6	265.5	15.3	233.4	42.7
1987	1,889.8	279.5	14.8	149.1	14.0
1988	2,051.6	345.9	16.9	161.9	66.4
1989	2,190.7	394.9	18.0	139.1	49.0
1990 [3]	2,411.6	440.3	18.3	220.8	n.a
1991	2,689.0	477.3	17.7	277.4	37.0
1992	2,999.7	535.2	17.8	310.7	57.9
1993	3,248.4	591.3	18.2	248.7	56.1
1994	3,433.1	655.8	19.1	184.7	64.5
1995 [3]	3,604.4	800.4	22.2	171.3	n.a
1996	3,734.1	978.1	26.2	129.7	177.7
1997	3,772.3	1,218.2	32.3	38.3	240.0
1998	3,721.1	1,216.9	32.7	–51.2	–1.2
1999 [3]	3,632.4	1,281.4	35.3	–88.7	n.a
2000 [3]	3,409.8	1,057.9	31.0	–222.6	n.a
2001	3,319.6	1,005.5	30.3	–90.2	–52.3
2002 [3]	3,540.4	1,199.6	33.9	220.8	n.a
2003	3,913.6	1,458.5	37.3	373.2	259.0

n.a. = not available

[1] Estimated by Treasury Department. These estimates exclude agency debt, the holdings of which are believed to be small. The data on foreign holdings are recorded by methods that are not fully comparable with the data on debt held by the public. Projections of foreign holdings are not available.

[2] Borrowing from the public is defined as equal to the change in debt held by the public from the beginning of the year to the end, except to the extent that the amount of debt is changed by reclassification

[3] Benchmark revisions reduced the estimated foreign holdings of the Federal debt as of December 1978; increased the estimated foreign holdings as of December 1984 and December 1989; reduced the estimated holdings as of December 1994 and March 2000; and increased the estimated holdings as of June 2002. A conceptual revision increased the estimated foreign holdings as of 1999. The change in debt that is recorded as held by foreign residents in these fiscal years reflects the benchmark or conceptual revisions as well as the net purchases of Federal securities. Borrowing is therefore not shown in these years.

that foreign residents own, after growing abruptly in the very early 1970s, did not change much again until the mid-1990s. During 1995–97, however, foreign holdings increased on average by around $200 billion each year, considerably more than total Federal borrowing from the public.[13] As a result, the Federal debt held by individuals and institutions within the United States decreased in absolute amount during those years, despite further Federal borrowing, and the percentage of Federal debt held by foreign residents grew from 19 percent at the end of 1994 to 32 percent at the end of 1997. In most subsequent years the change in foreign debt holdings was much smaller, but in 2003 the Federal debt held by foreign residents increased by $259 billion or from 34 to 37 percent of Federal debt.

Foreign holdings of Federal debt are around 14 percent of the foreign-owned assets in the United States,

[13] Table 15–6 does not show a number for the increase in foreign holdings in 1995 because of a benchmark revision. As explained in footnote 5 to that table, a benchmark revision reduced the estimated holdings as of December 1994 (by $47.9 billion). Because estimates of foreign holdings were not revised retroactively, the increase in 1995 was more than the difference between the beginning and end of year amounts as now calculated. Before the benchmark revision, the increase was estimated to be $192.6 billion.

depending on the method of measuring total assets. The foreign purchases of Federal debt securities do not measure the full impact of the capital inflow from abroad on the market for Federal debt securities. The capital inflow supplies additional funds to the credit market generally, and thus affects the market for Federal debt. For example, the capital inflow includes deposits in U.S. financial intermediaries that themselves buy Federal debt.

Federal, Federally Guaranteed, and Other Federally Assisted Borrowing

The effect of the Government on borrowing in the credit market arises not only from its own borrowing to finance Federal operations but also from its assistance to certain borrowing by the public. The Government guarantees borrowing by private and other non-Federal lenders, which is another term for guaranteed lending. In addition to its guarantees, it has established private corporations called “Government-sponsored enterprises,” or GSEs, to provide financial intermediation for specified public purposes; it exempts the interest on most State and local government debt from income tax; it permits mortgage interest to be deducted in calculating taxable income; and it insures the deposits of banks and thrift institutions, which themselves make loans.

Federal credit programs and other forms of assistance are discussed in chapter 7, “Credit and Insurance.” Detailed data are presented in tables at the end of that chapter. Table 7–9 summarizes GSE borrowing and lending.

FEDERAL RECEIPTS AND COLLECTIONS

16. FEDERAL RECEIPTS

Receipts (budget and off-budget) are taxes and other collections from the public that result from the exercise of the Federal Government's sovereign or governmental powers. The difference between receipts and outlays determines the surplus or deficit.

The Federal Government also collects income from the public from market-oriented activities. Collections from these activities, which are subtracted from gross outlays, rather than added to taxes and other governmental receipts, are discussed in the following chapter.

Growth in receipts.—Total receipts in 2005 are estimated to be $2,036.3 billion, an increase of $238.2 billion or 13.2 percent relative to 2004. Receipts are projected to grow at an average annual rate of 6.5 percent between 2005 and 2009, rising to $2,616.4 billion. This growth in receipts is largely due to assumed increases in incomes resulting from both real economic growth and inflation. These estimates reflect a downward adjustment for revenue uncertainty of $20 billion in 2004 and $15 billion in 2005. As this description suggests, these latter amounts reflect an additional adjustment to receipts beyond what the economic and tax models forecast and have been made in the interest of cautious and prudent forecasting.

As a share of GDP, receipts are projected to increase from 15.7 percent in 2004 to 16.9 percent in 2005. The receipts share of GDP is projected to increase annually thereafter, rising to 17.8 percent in 2009.

Table 16–1. RECEIPTS BY SOURCE—SUMMARY

(In billions of dollars)

Source	2003 actual	Estimate					
		2004	2005	2006	2007	2008	2009
Individual income taxes	793.7	765.4	873.8	956.5	1,049.3	1,133.4	1,209.9
Corporation income taxes	131.8	168.7	230.2	250.0	251.0	252.1	255.7
Social insurance and retirement receipts	713.0	732.4	793.9	834.0	878.7	918.8	960.2
(On-budget)	(189.1)	(198.4)	(218.8)	(230.9)	(242.4)	(251.2)	(261.2)
(Off-budget)	(523.8)	(534.0)	(575.1)	(603.1)	(636.3)	(667.6)	(698.9)
Excise taxes	67.5	70.8	73.2	75.8	77.9	80.0	82.2
Estate and gift taxes	22.0	23.9	21.4	23.9	21.5	22.2	23.6
Customs duties	19.9	22.6	22.1	24.4	26.2	27.6	30.0
Miscellaneous receipts	34.5	34.3	36.5	41.2	46.2	51.2	54.8
Adjustment for revenue uncertainty		–20.0	–15.0				
Total receipts	**1,782.3**	**1,798.1**	**2,036.3**	**2,205.7**	**2,350.8**	**2,485.3**	**2,616.4**
(On-budget)	*(1,258.5)*	*(1,264.1)*	*(1,461.2)*	*(1,602.5)*	*(1,714.5)*	*(1,817.7)*	*(1,917.5)*
(Off-budget)	*(523.8)*	*(534.0)*	*(575.1)*	*(603.1)*	*(636.3)*	*(667.6)*	*(698.9)*

Table 16–2. EFFECT ON RECEIPTS OF CHANGES IN THE SOCIAL SECURITY TAXABLE EARNINGS BASE

(In billions of dollars)

	Estimate				
	2005	2006	2007	2008	2009
Social security (OASDI) taxable earnings base increases:.					
$87,900 to $89,700 on Jan. 1, 2005	0.8	2.2	2.5	2.8	3.0
$89,700 to $93,000 on Jan. 1, 2006		1.6	4.3	4.7	5.2
$93,000 to $97,500 on Jan. 1, 2007			2.2	5.9	6.5
$97,500 to $101,400 on Jan. 1, 2008				1.9	5.1
$101,400 to $106,200 on Jan. 1, 2009					2.4

ENACTED LEGISLATION

Several laws were enacted in 2003 that have an effect on governmental receipts. The major legislative changes affecting receipts are described below.

JOBS AND GROWTH TAX RELIEF RECONCILIATION ACT

In January 2003, President Bush proposed an economic growth package designed to reinvigorate the economic recovery, create jobs and enhance long-term economic growth. Congress acted quickly and on May 28, 2003 President Bush signed the Jobs and Growth Tax Relief Reconciliation Act (2003 jobs and growth tax cut), which included all the key features of his proposal. In addition to providing $20 billion in temporary fiscal assistance to the States, this Act accelerated many of the individual income tax reductions provided in the Economic Growth and Tax Relief Reconciliation Act of 2001 (2001 tax cut), increased temporarily the alternative minimum tax (AMT) exemption amount, reduced temporarily tax rates on dividends and capital gains, and increased temporarily incentives designed to speed up investment. The major provisions of the Act that affect receipts are described below. The year-by-year effect of these changes (as well as some of the changes provided in the 2001 tax cut) on various provisions of the tax code is shown in Chart 16–1.

Chart 16–1. MAJOR PROVISIONS OF THE TAX CODE UNDER THE 2001 AND 2003 TAX CUTS

Provision	2003	2004	2005	2006	2007	2008	2009	2010	2011
Individual Income Tax Rates	Rates reduced to 35, 33, 28, and 25 percent								Rates increased to 39.6, 36, 31, and 28 percent
10 Percent Bracket	Bracket upper income level increased to $7,000/$14,000 for single/joint filers and inflation-indexed		Bracket upper income level reduced to $6,000/$12,000 for single/joint filers			Bracket upper income level increased to $7,000/$14,000 for single/joint filers and inflation-indexed			Bracket eliminated, making lowest bracket 15 percent
15 Percent Bracket for Joint Filers	Top of bracket for joint filers increased to 200 percent of top of bracket for single filers		Top of bracket for joint filers reduced to 180 percent of top of bracket for single filers	Top of bracket for joint filers increased to 187 percent of top of bracket for single filers	Top of bracket for joint filers increased to 193 percent of top of bracket for single filers	Top of bracket for joint filers increased to 200 percent of top of bracket for single filers			Top of bracket for joint filers reduced to 167 percent of top of bracket for single filers
Standard Deduction for Joint Filers	Standard deduction for joint filers increased to 200 percent of standard deduction for single filers		Standard deduction for joint filers reduced to 174 percent of standard deduction for single filers	Standard deduction for joint filers increased to 184 percent of standard deduction for single filers	Standard deduction for joint filers increased to 187 percent of standard deduction for single filers	Standard deduction for joint filers increased to 190 percent of standard deduction for single filers	Standard deduction for joint filers increased to 200 percent of standard deduction for single filers		Standard deduction for joint filers reduced to 167 percent of standard deduction for single filers
Child Credit	Tax credit for each qualifying child under age 17 increased to $1,000		Tax credit for each qualifying child under age 17 reduced to $700				Tax credit for each qualifying child under age 17 increased to $800	Tax credit for each qualifying child under age 17 increased to $1,000	Tax credit for each qualifying child under age 17 reduced to $500
Estate Taxes	Top rate reduced to 49 percent	Top rate reduced to 48 percent Exempt amount increased to $1.5 million	Top Rate reduced to 47 percent	Top rate reduced to 46 percent Exempt amount increased to $2 million	Top rate reduced to 45 percent		Exempt amount increased to $3.5 million	Estate tax repealed	Top rate increased to 60 percent Exempt amount reduced to $1 million

Chart 16–1. MAJOR PROVISIONS OF THE TAX CODE UNDER THE 2001 AND 2003 TAX CUTS—Continued

Provision	2003	2004	2005	2006	2007	2008	2009	2010	2011
Small Business Expensing	Deduction increased to $100,000, reduced by amount qualifying property exceeds $400,000, and both amounts inflation-indexed Applies to software			Deduction declines to $25,000, reduced by amount qualifying property exceeds $200,000, and amounts not inflation-indexed Does not apply to software					
Capital Gains	Tax rate on captial gains reduced to 5/15 percent					Tax on captial gains eliminated for taxpayers in 10/15 percent tax brackets	Tax rate on captial gains increased to 10/20 percent		
Dividends	Tax rate on dividends reduced to 5/15 percent					Tax on dividends eliminated for taxpayers in 10/15 percent tax brackets	Dividends taxed at standard income tax rates		
Bonus Depreciation	Bonus depreciation increased to 50 percent of qualified property aquired after 5/5/03		Bonus depreciation expires						
Alternative Minimum Tax	AMT exemption amount increased to $40,250/$58,000 for single/joint filers		AMT exemption amount reduced to $33,750/ $45,000 for single /joint filers						

Accelerate Individual Income Tax Reductions Provided in the 2001 Tax Cut

Accelerate 10-percent individual income tax rate bracket expansion.—The 2001 tax cut created a 10-percent individual income tax bracket, which applied to the first $6,000 of taxable income for single taxpayers and married taxpayers filing separate returns (increasing to $7,000 for taxable years beginning after December 31, 2007 and before January 1, 2011), the first $10,000 of taxable income for heads of household, and the first $12,000 of taxable income for married taxpayers filing a joint return (increasing to $14,000 for taxable years beginning after December 31, 2007 and before January 1, 2011). These amounts were adjusted annually for inflation after December 31, 2008. The 2003 jobs and growth tax cut accelerated the expansions of the 10-percent tax rate bracket scheduled to be effective beginning in taxable year 2008, to be effective in taxable years 2003 and 2004. For taxable years beginning after 2004 and before January 1, 2011, the taxable income levels for the 10-percent individual income tax rate bracket will revert to the levels provided under the 2001 tax cut. The 10-percent bracket will be eliminated for taxable years beginning after December 31, 2010.

Accelerate reduction in individual income tax rates.—Under the 2001 tax cut, the statutory individual income tax rate brackets of 28, 31, 36 and 39.6 percent were temporarily replaced with a rate structure of 25, 28, 33 and 35 percent. The reduced tax rate structure was phased in over a period of six years, with reductions scheduled for 2001, 2002, 2004, and 2006. The new tax rate structure was fully effective for taxable years 2006 through 2010. The 2003 jobs and growth tax cut accelerated the reductions in the statutory individual income tax rate structure scheduled to be effective beginning in taxable years 2004 and 2006, to be effective beginning in taxable year 2003. The statutory individual income tax rate brackets will revert to 28, 31, 36 and 39.6 percent, effective for taxable years beginning after December 31, 2010.

Accelerate increase in standard deduction for married taxpayers filing a joint return.— Under the 2001 tax cut, the standard deduction for married taxpayers filing a joint return, which was 167 percent of the standard deduction for unmarried individuals, was increased to double the standard deduction for single taxpayers over a five-year period. Under the phasein, the standard deduction for married taxpayers filing a joint return increased to 174 percent of the standard deduction for single taxpayers in taxable year 2005, 184 percent in taxable year 2006, 187 percent in taxable year 2007, 190 percent in taxable year 2008, and 200 percent in taxable years 2009 and 2010. The 2003 jobs and growth tax cut accelerated the increase in the standard deduction for married taxpayers filing a joint return to 200 percent of the standard deduction for single taxpayers, effective for taxable years 2003 and 2004. For taxable years 2005 through 2010, the standard deduction for married taxpayers filing a joint return will revert to the levels provided under the 2001 tax cut. The standard deduction for married taxpayers filing a joint return will decline to 167 percent of the standard deduction for single taxpayers, effective for taxable years beginning after December 31, 2010.

Accelerate expansion of the 15-percent individual income tax rate bracket for married taxpayers filing a joint return.—Under the 2001 tax cut, the maximum taxable income in the 15-percent individual income tax rate bracket for married taxpayers filing a joint return, which was 167 percent of the corresponding amount for an unmarried individual, was increased to twice the corresponding amount for unmarried individuals over a four-year period. Under the phasein, the maximum taxable income in the 15-percent tax rate bracket for married taxpayers filing a joint return increased to 180 percent of the corresponding amount for single taxpayers in taxable year 2005, 187 percent in taxable year 2006, 193 percent in taxable year 2007, and 200 percent in taxable years 2008, 2009 and 2010. The 2003 jobs and growth tax cut accelerated the increase in the size of the 15-percent tax rate bracket for married taxpayers filing a joint return to twice the corresponding tax rate bracket for single taxpayers, effective for taxable years 2003 and 2004. For taxable years 2005 through 2010, the size of the 15-percent tax rate bracket for married taxpayers filing a joint return will revert to the levels provided under the 2001 tax cut. The maximum taxable income in the 15-percent tax rate bracket for married taxpayers filing a joint return will decline to 167 percent of the corresponding amount for single taxpayers, effective for taxable years beginning after December 31, 2010.

Accelerate increase in child tax credit.—Under the 2001 tax cut, the maximum amount of the tax credit for each qualifying child under the age of 17 increased from $500 to $1,000 over a period of 10 years, as follows: the credit increased to $600 for taxable years 2001 through 2004, $700 for taxable years 2005 through 2008, $800 for taxable year 2009, and $1,000 for taxable year 2010. The 2003 jobs and growth tax cut accelerated the increase in the credit to $1,000 per child, effective for taxable years 2003 and 2004. For taxable years 2005 through 2010, the credit will revert to the levels provided under the 2001 tax cut. The credit will decline to $500 for taxable years beginning after December 31, 2010.

For 2003, most eligible taxpayers received the benefit of the increase in the credit through an advanced payment of up to $400 per child, issued by the Department of Treasury in the form of a check. The amount of the advanced payment was based on information provided on each taxpayer's 2002 tax return, filed in 2003.

Provide Alternative Minimum Tax (AMT) Relief

Increase AMT exemption amount.—An alternative minimum tax is imposed on individuals to the extent that the tentative minimum tax exceeds the regular tax. An individual's tentative minimum tax generally is equal to the sum of: (1) 26 percent of the first $175,000 ($87,500 in the case of a married individual filing a separate return) of alternative minimum taxable income (taxable income modified to take account of specified preferences and adjustments) in excess of an exemption amount and (2) 28 percent of the remaining alternative minimum taxable income. The exemption amounts, as provided under the 2001 tax cut, were: (1) $49,000 for married taxpayers filing a joint return and surviving spouses for taxable years 2001 through 2004, declining in 2005 to the pre-2001 tax cut level of $45,000; (2) $35,750 for single taxpayers for taxable years 2001 through 2004, returning to $33,750 for taxable years beginning in 2005; and (3) $24,500 for married taxpayers filing a separate return, estates and trusts, for taxable years 2001 through 2004, returning to $22,500 for taxable years beginning in 2005. The exemption amounts are phased out by an amount equal to 25 percent of the amount by which the individual's alternative minimum taxable income exceeds: (1) $150,000 for married taxpayers filing a joint return and surviving spouses, (2) $112,500 for single taxpayers, and (3) $75,000 for married taxpayers filing a separate return, estates and trusts. Effective for taxable years 2003 and 2004, the 2003 jobs and growth tax cut increased the alternative minimum tax exemption amount to $58,000 for married taxpayers filing a joint return and surviving spouses, to $40,250 for single taxpayers, and to $29,000 for married taxpayers filing a separate return, estates and trusts. For taxable years beginning after 2004, the exemption amounts will return to the levels prior to the 2001 tax cut.

Provide Growth Incentives for Business

Increase and extend the special depreciation allowance for certain property.—Taypayers are allowed to recover the cost of certain property used in a trade or business or for the production of income through annual depreciation deductions. The amount of the allowable depreciation deduction for a taxable year generally is determined under the modified accelerated cost recovery system, which assigns applicable recovery periods and depreciation methods to different types of property.

The Job Creation and Worker Assistance Act of 2002 (2002 economic stimulus bill) provided an additional first-year depreciation deduction equal to 30 percent of the adjusted basis of the property, for qualifying assets (1) acquired after September 10, 2001 and before September 11, 2004 (but only if no binding written contract for the acquisition of the property was in effect before September 11, 2001) or (2) acquired pursuant to a written binding contract that was entered into after September 10, 2001 and before September 11, 2004. This first-year depreciation deduction was allowed for both regular and alternative minimum tax purposes in the year the property was placed in service. The basis of the property and the remaining allowable depreciation deductions had to be adjusted to reflect the additional first-year depreciation deduction. Property qualifying for the additional first-year depreciation deduction included tangible property with a depreciation recovery period of 20 years or less, certain software, water utility property, and qualified leasehold improvements. To qualify for the special depreciation allowance, the original use of the property must have commenced with the taxpayer after September 10, 2001 (except for certain sale-leaseback property) and the property was required to be placed in service before January 1, 2005 (January 1, 2006 for certain property having longer production periods). The 2003 jobs and growth tax cut extended the final acquisition deadlines for property qualifying for the 30 percent additional first-year depreciation deduction from September 11, 2004 to January 1, 2005. In addition, this Act permitted an additional first-year depreciation deduction equal to 50 percent of the adjusted basis of the property (in lieu of the 30-percent additional deduction) for property acquired after May 5, 2003 and before January 1, 2005 (provided no binding written contract for the acquisition of the property was in effect before May 6, 2003). Qualified property was defined in the same manner as for purposes of the 30-percent additional first-year depreciation deduction, except the original use of the property was required to commence with the taxpayer after May 5, 2003.

Increase expensing for small business.—In lieu of depreciation, a small business taxpayer may elect to deduct up to $25,000 of the cost of qualifying property placed in service during the taxable year. Qualifying property includes certain tangible property that is acquired by purchase for use in the active conduct of a trade or business. The amount that a taxpayer may expense is reduced by the amount by which the taxpayer's cost of qualifying property exceeds $200,000. The deduction is also limited in any taxable year by the amount of taxable income derived from the active conduct by the taxpayer of any trade or business. An election to expense these costs generally is made on the taxpayer's original return for the taxable year to which the election relates, and may be revoked only with the consent of the IRS Commissioner. The 2003 jobs and growth tax cut increased the maximum deduction amount to $100,000, effective for qualifying property (expanded to include off-the-shelf computer software) placed in service in taxable years beginning in 2003, 2004, and 2005. The amount that a taxpayer may expense is reduced by the amount by which the taxpayer's cost of qualifying property exceeds $400,000. Both the deduction and annual investment limits are indexed annually for inflation, effective for taxable years beginning after 2003 and before 2006. Additionally, with respect to a taxable year beginning after 2002 and before 2006, taxpayers are permitted to make or revoke expensing elections on amended returns without the consent of the IRS Commissioner.

Modify Taxation of Capital Gains and Dividends

Reduce individual income tax rates on net capital gains.—Prior to enactment of the 2003 jobs and growth tax cut, the maximum tax rate on net capital gains (the excess of net long-term gains over net short-term losses) was 20 percent for taxpayers in individual income tax rate brackets exceeding 15 percent and 10 percent for lower income taxpayers. Effective for sales or exchanges of capital assets on or after May 6, 2003 and before January 1, 2009, this Act reduced the maximum tax rate on net capital gains to 15 percent for taxpayers in individual income tax rate brackets above 15 percent and to 5 percent (zero, in 2008) for lower income taxpayers. After December 31, 2008, net capital gains will be taxed at maximum rates of 20 and 10 percent.

Reduce individual income tax rates on dividends.—Prior to enactment of the 2003 jobs and growth tax cut, dividends received by an individual shareholder were taxed as ordinary income, at rates as high as 38.6 percent in 2003. Effective for taxable years beginning after December 31, 2002 and before January 1, 2009, this Act reduced the maximum tax rate on dividends received by an individual shareholder from domestic and qualified foreign corporations to 15 percent for taxpayers in individual income tax rate brackets above 15 percent and to 5 percent (zero, in 2008) for lower income taxpayers. After December 31, 2008, dividends will be taxed as ordinary income.

Modify Estimated Tax Payments by Corporations

Modify the timing of estimated tax payments by corporations.—Corporations generally are required to pay their income tax liability in quarterly estimated payments. For corporations that keep their accounts on a calendar year basis, these payments are due on or before April 15, June 15, September 15 and December 15 (if these dates fall on a holiday or weekend, payment is due on the next business day). The 2003 jobs and growth tax cut allowed corporations to delay 25 percent of the estimated payment otherwise due on September 15, 2003 until October 1, 2003.

MEDICARE PRESCRIPTION DRUG, IMPROVEMENT, AND MODERNIZATION ACT OF 2003

President Bush signed this Act, which he referred to as "the greatest advance in health care coverage for America's seniors since the founding of Medicare," on December 8, 2003. In addition to providing prescription drug coverage to more than 40 million seniors and to the disabled, other provisions of this Act increased payments to Medicare providers, provided new preventive health care benefits to seniors, established health care savings accounts, and curtailed the number of employers expected to drop retiree health care coverage. The major provisions of this Act that affect receipts are described below.

Create Health Savings Accounts (HSAs).—Effective January 4, 2004, eligible individuals, their family members and employers are allowed to make tax-free contributions to a Health Savings Account. Eligible individuals are those covered by a high-deductible health plan who cannot be claimed as a dependent on another person's tax return and who are not entitled to benefits under Medicare. A high-deductible plan is one that in 2003 had an annual deductible of at least $1,000 in the case of self-only coverage and $2,000 in the case of family coverage, and a cap on out-of-pocket expenses of $5,000 in the case of self-only coverage and $10,000 in the case of family coverage. The annual deductible and out-of-pocket expense amounts are indexed annually for inflation. Contributions to a HSA made by an eligible individual are deductible and employer contributions made on behalf of an individual (including contributions made through a cafeteria plan) are excluded from gross income and wages for income and employment tax purposes to the extent the contribution would be deductible if made by the employee. The maximum aggregate annual contribution that may be made to a HSA is the lesser of 100 percent of the annual deductible under the high-deductible plan, or the maximum deductible permitted under an Archer Medical Savings Account (MSA) high-deductible health plan, as adjusted for inflation. For 2004, the maximum contribution is $2,600 in the case of a self-only plan and $5,150 in the case of family coverage. Contributions to an Archer MSA reduce the annual contribution limit for HSAs. The annual contribution limits are increased for individuals who have attained age 55 by the end of the taxable year; these "catch-up" contributions are greater than the otherwise applicable contribution limit by the following amounts: $500 in 2004, $600 in 2005, $700 in 2006, $800 in 2007, $900 in 2008, and $1,000 in 2009 and subsequent years. A married couple can make two catch-up contributions as long as both spouses are at least age 55. Distributions from an HSA for qualified medical expenses of the individual and his or her spouse or dependents generally are tax-free. Qualified expenses include prescription and nonprescription drugs, qualified long-term care services and long-term care insurance, COBRA coverage, Medicare expenses (excluding Medigap), and retiree health expenses for individuals age 65 and older. Distributions from an HSA that are not for qualified medical expenses are included in gross income and are subject to an additional 10-percent penalty unless made after death, disability, or the individual attains the age of Medicare eligibility.

Exclude from income Federal subsidy payments to employers who continue prescription drug coverage for retirees.—To encourage employers to continue providing prescription drug benefits to their retirees, this Act provided a subsidy to firms with a retiree health plan certified to be at least the equivalent of the standard Medicare drug plan. The subsidy, which is 28 cents for every dollar between $250 and $5,000 spent on a drug benefit for an employee, is excluded from the gross income of the employer. The exclusion, which applies to the regular tax and to the alternative minimum tax, is effective for taxable years ending after the date of enactment.

MILITARY FAMILY TAX RELIEF ACT OF 2003

This Act, which doubled military death gratuity payments from $6,000 to $12,000 and provided tax reductions to military personnel and their families, was signed by President Bush on November 11, 2003. The major provisions of this Act that affect receipts are described below.

Provide an above-the-line deduction for travel expenses of National Guard and Reserve members.—National Guard and Reserve members are allowed to claim itemized deductions for overnight transportation, meals, and lodging expenses that are incurred and not reimbursed when they travel away from home to attend National Guard and Reserve meetings. Under prior law, such expenses had to be combined with other miscellaneous itemized deductions and were deductible only to the extent that the aggregate of the taxpayer's miscellaneous itemized deductions exceeded two percent of adjusted gross income. This Act provided an above-the-line deduction for the nonreimbursed transportation, meals and lodging expenses of National Guard and Reserve members who must travel more than 100 miles away from home to attend National Guard and Reserve meetings. The deduction, which is effective with respect to expenses paid or incurred in taxable years beginning after December 31, 2002, cannot exceed the general Federal Government per diem rate applicable to the locale in which the expenses are incurred.

Provide special rules for the exclusion of gain on the sale of a principal residence by members of the uniformed services or the Foreign Service.—Under current law, a taxpayer may exclude from tax up to $250,000 ($500,000 for married taxpayers filing a joint return) of the gain realized on the sale or exchange of a principal residence. To be eligible for the exclusion, the taxpayer must have owned and used the residence as a principal residence for at least two of the five years ending on the date of the sale or exchange. A taxpayer who fails to meet these requirements by reason of a change of place of employment, health, or unforeseen circumstances (to the extent provided under regulations) is able to exclude a lesser amount from tax, equal to $250,000/$500,000 times the portion of the two years that the ownership and use requirements are met. This Act modified these rules for members of the uniformed services or Foreign Service, effective for sales or exchanges after May 6, 1997. Under this Act these individuals may elect to suspend the five-year period of current law for a maximum of ten years during certain absences due to service. If the election is made, the five-year period ending on the date of the sale or exchange of a principal residence does not include any period, up to ten years, during which the taxpayer or the taxpayer's spouse was on qualified official extended duty as a member of the uniformed services or in the Foreign Service of the United States. For these purposes qualified official extended duty is defined as any period of duty pursuant to a call or order to such duty for a period in excess of 90 days or for an indefinite period at a place of duty at least 50 miles away from the taxpayer's principal residence or under orders compelling residence in Government furnished quarters. The election may be made with respect to only one property for a suspension period.

Increase exclusion from income for certain death gratuities paid with respect to deceased members of the armed forces.—This Act increased from $6,000 to $12,000, certain death gratuities paid to survivors of members of the armed forces who die while on active duty, inactive duty training, or authorized travel. Survivors of persons who die within 120 days after discharge or release from active duty, inactive duty training, or authorized travel are also paid the death gratuity if the death resulted from an injury or disease incurred or aggravated during the active duty, inactive duty training or authorized travel. Under prior law, only $3,000 of the military death gratuity was excluded from gross income. This Act increased the exclusion from gross income for military death gratuity payments to $12,000, effective with respect to deaths occurring after September 10, 2001.

Provide exclusion from income for amounts received under Department of Defense Homeowners Assistance Program.—The Department of Defense Homeowners Assistance Program (HAP) provides payments to certain employees and members of the armed forces to offset the adverse effects on housing values that result from a military base realignment or closure. Under prior law, amounts received under HAP were included in gross income. This Act generally exempted from gross income amounts received under HAP, up to the reduction in the fair market value of the property. This change was effective for payments made after November 11, 2003.

Modify other tax provisions.—Other changes provided in this Act authorized the expansion of extended tax filing and payment deadlines provided to individuals serving in a combat zone to individuals participating in a contingency operation, clarified the tax treatment of certain dependent care assistance programs provided to members of the uniformed services of the United States, allowed service academy appointments to be considered scholarships for purposes of qualified tuition programs and Coverdell Education Savings Accounts, suspended the tax-exempt status of designated terrorist organizations, and provided tax relief to families of astronauts who lose their lives in the line of duty after December 31, 2002. In addition, for purposes of determining the tax-exempt status of veteran's organizations, this Act expanded membership requirements to include ancestors or lineal descendants of past or present members of the armed forces, or of cadets.

UNITED STATES-CHILE FREE TRADE AGREEMENT IMPLEMENTATION ACT

This Act implemented the U.S.-Chile Free Trade Agreement (FTA), as signed by the United States and Chile on June 6, 2003. The U.S.-Chile FTA increased market access for American goods and services in Chile and provided U.S. producers and consumers access to lower-cost Chilean goods and services in a manner that was not disruptive to the U.S. economy. It also set the standard in Latin America for progressively opening other countries' economies and pointed the way to a hemisphere united by economic opportunity, freedom, the rule of law, and democracy.

UNITED STATES-SINGAPORE FREE TRADE AGREEMENT IMPLEMENTATION ACT

This Act implemented the U.S.-Singapore Free Trade Agreement (FTA), as signed by the United States and Singapore on May 6, 2003. The U.S.-Singapore FTA provided tariff-free access to Singapore for all U.S. goods, including textile and agriculture products; opened opportunities for U.S. services businesses; and addressed other barriers to trade. As the first U.S. Free Trade Agreement with an Asian-Pacific country, provisions in this agreement will serve as the foundation for agreements with other countries in the region.

ADMINISTRATION PROPOSALS

The President's policy initiatives include permanent extension of the increased expensing for small businesses and reductions in taxes on capital gains and dividends provided in the 2003 jobs and growth tax cut, as well as extension through 2010 of the accelerated individual income tax reductions provided in that same legislation. They also include permanent extension of the provisions of the 2001 tax cut scheduled to sunset on December 31, 2010, permanent extension of the research and experimentation tax credit, and extension of many other expiring provisions. In addition, the President's initiatives include incentives for charitable giving, strengthening education, investing in health care, protecting the environment, increasing energy production, and promoting energy conservation.

This Budget also includes proposals designed to increase opportunities for saving by simplifying and rationalizing the many tax preferred savings vehicles provided under current law; simplify the tax code, improve tax compliance, and curtail abusive tax avoidance activities; and strengthen the employer-based pension system.

MAKE PERMANENT THE TAX CUTS ENACTED IN 2001 AND 2003

Extend Through 2010 Certain Provisions of the 2003 Jobs and Growth Tax Cut

Extend through 2010 accelerated individual income tax reductions.—The Administration proposes to extend through December 31, 2010, the accelerated increase in the child credit, the accelerated expansion of the 10-percent individual income tax bracket, and the accelerated expansions of the standard deduction and 15-percent individual income tax bracket for married taxpayers filing a joint return, which expire on December 31, 2004.

Extend Permanently Certain Provisions of the 2001 Tax Cut and the 2003 Jobs and Growth Tax Cut

Extend permanently reductions in individual income taxes on capital gains and dividends.—The maximum individual income tax rate on net capital gains and dividends is 15 percent for taxpayers in individual income tax rate brackets above 15 percent and 5 percent (zero in 2008) for lower income taxpayers. The Administration proposes to extend permanently these reduced rates (15 percent and zero), which are scheduled to expire on December 31, 2008.

Extend permanently increased expensing for small business.—Small businesses taxpayers are allowed to expense up to $100,000 in annual investment expenditures for qualifying property (expanded to include off-the-shelf computer software) placed in service in taxable years 2003, 2004, and 2005. The amount that may be expensed is reduced by the amount by which the taxpayer's cost of qualifying property exceeds $400,000. Both the deduction and annual investment limits are indexed annually for inflation, effective for taxable years beginning after 2003 and before 2006. Also, with respect to a taxable year beginning after 2002 and before 2006, taxpayers are permitted to make or revoke expensing elections on amended returns without the consent of the IRS Commissioner. The Administration proposes to extend permanently each of these temporary provisions, applicable for qualifying property (including off-the-shelf computer software) placed in service in taxable years beginning after 2005.

Extend permanently provisions expiring in 2010.—Most of the provisions of the Economic Growth and Tax Relief Reconciliation Act of 2001 sunset on December 31, 2010. The Administration proposes to extend those provisions permanently.

TAX INCENTIVES

Simplify and Encourage Saving

Expand tax-free savings opportunities.—Under current law, individuals can contribute to traditional IRAs, nondeductible IRAs, and Roth IRAs, each subject to different sets of rules. For example, contributions to traditional IRAs are deductible, while distributions are taxed; contributions to Roth IRAs are taxed, but distributions are excluded from income. In addition, eligibility to contribute is subject to various age and income limits. While primarily intended for retirement saving, withdrawals for certain education, medical, and other non-retirement expenses are penalty free. The eligibility and withdrawal restrictions for these accounts complicate compliance and limit incentives to save.

The Administration proposes to replace current law IRAs with two new savings accounts: a Lifetime Savings Account (LSA) and a Retirement Savings Account (RSA). Regardless of age or income, individuals could make annual nondeductible contributions of $5,000 to an LSA and $5,000 (or earnings if less) to an RSA. Distributions from an LSA would be excluded from income and, unlike current law, could be made at anytime for any purpose without restriction. Distributions from an RSA would be excluded from income after attaining age 58 or in the event of death or disability. All other distributions would be included in income (to the extent they exceed basis) and subject to an additional tax. Distributions would be deemed to come from basis first. The proposal would be effective for contributions made after December 31, 2004 and future year contribution limits would be indexed for inflation.

Existing Roth IRAs would be renamed RSAs and would be subject to the new rules for RSAs. Existing traditional and nondeductible IRAs could be converted into an RSA by including the conversion amount (excluding basis) in gross income, similar to a current-law Roth conversion. However, no income limit would apply to the ability to convert. Taxpayers who convert IRAs to RSAs could spread the included conversion amount over several years. Existing traditional or nondeductible IRAs that are not converted to RSAs could not accept new contributions. New traditional IRAs could be created to accommodate rollovers from employer plans, but they could not accept new individual contributions. Individuals wishing to roll an amount directly from an employer plan to an RSA could do so by including the rollover amount (excluding basis) in gross income (i.e., "converting" the rollover, similar to a current law Roth conversion).

Consolidate employer-based savings accounts.—Current law provides multiple types of tax-preferred employer-based savings accounts to encourage saving for retirement. The accounts have similar goals but are subject to different sets of rules regulating eligibility, contribution limits, tax treatment, and withdrawal restrictions. For example, 401(k) plans for private employers, SIMPLE 401(k) plans for small employers, 403(b) plans for 501(c)(3) organizations and public schools, and 457 plans for State and local governments are all subject to different rules. To qualify for tax benefits, plans must satisfy multiple requirements. Among the requirements, the plan may not discriminate in favor of highly compensated employees with regard either to coverage or to amount or availability of contributions or benefits. Rules covering employer-based savings accounts are among the lengthiest and most complicated sections of the tax code and associated regulations. This complexity imposes substantial costs on employers, participants, and the government, and likely has inhibited the adoption of retirement plans by employers, especially small employers.

The Administration proposes to consolidate 401(k), SIMPLE 401(k), 403(b), and 457 plans, as well as SIMPLE IRAs and SARSEPs, into a single type of plan—Employee Retirement Savings Accounts (ERSAs) that would be available to all employers. ERSA non-discrimination rules would be simpler and include a new ERSA non-discrimination safe-harbor. Under one of the safe-harbor options, a plan would satisfy the nondiscrimination rules with respect to employee deferrals and employee contributions if it provided a 50-percent match on elective contributions up to six percent of compensation. By creating a simplified and uniform set of rules, the proposal would substantially reduce complexity. The proposal would be effective for taxable years beginning after December 31, 2004.

Establish Individual Development Accounts (IDAs).—The Administration proposes to allow eligible individuals to make contributions to a new savings vehicle, the Individual Development Account, which would be set up and administered by qualified financial institutions, nonprofit organizations, or Indian tribes (qualified entities). Citizens or legal residents of the United States between the ages of 18 and 60 who cannot be claimed as a dependent on another taxpayer's return, are not students, and who meet certain income limitations would be eligible to establish and contribute to an IDA. A single taxpayer would be eligible to establish and contribute to an IDA if his or her modified AGI in the preceding taxable year did not exceed $20,000 ($30,000 for heads of household, and $40,000 for married taxpayers filing a joint return). These thresholds would be indexed annually for inflation beginning in 2006. Qualified entities that set up and administer IDAs would be required to match, dollar-for-dollar, the first $500 contributed by an eligible individual to an IDA in a taxable year. Qualified entities would be allowed a 100 percent tax credit for up to $500 in annual matching contributions to each IDA, and a $50 tax credit for each IDA maintained at the end of a taxable year with a balance of not less that $100 (excluding the taxable year in which the account was established). Matching contributions and the earnings on those contributions would be deposited in a separate "parallel account." Contributions to an IDA by an eligible individual would not be deductible, and earnings on those contributions would be included in income. Matching contributions by qualified entities and the earnings on those contributions would be tax-free. Withdrawals from the parallel account may be made only for qualified purposes (higher education, the first-time purchase of a home, business start-up, and qualified rollovers). Withdrawals from the IDA for other than qualified purposes may result in the forfeiture of some or all matching contributions and the earnings on those contributions. The proposal would be effective for contributions made after December 31, 2004 and before January 1, 2012, to the first 900,000 IDA accounts opened before January 1, 2010.

Invest in Health Care

Provide refundable tax credit for the purchase of health insurance.—Current law provides a tax preference for employer-provided group health insurance plans, but not for individually purchased health insurance coverage except to the extent that deductible medical expenses exceed 7.5 percent of AGI, the individual has self-employment income, or the individual is eligible under the Trade Act of 2002 to purchase certain types of qualified health insurance. The Administration proposes to make health insurance more affordable for individuals not covered by an employer plan or a public program. Effective for taxable years beginning after December 31, 2004, a new refundable tax credit would be provided for the cost of health insurance purchased by individuals under age 65. The credit would provide a subsidy for a percentage of the health insurance premium, up to a maximum includable premium. The maximum subsidy percentage would be 90 percent for low-income taxpayers and would phase down with income. The maximum credit would be $1,000 for an adult and $500 for a child. The credit would be phased out at $30,000 for single taxpayers and $60,000 for families purchasing a family policy.

Individuals could claim the tax credit for health insurance premiums paid as part of the normal tax-filing process. Alternatively, beginning July 1, 2006, the tax credit would be available in advance at the time the individual purchases health insurance. The advance credit would reduce the premium paid by the individual to the health insurer, and the health insurer would be reimbursed directly by the Department of Treasury for the amount of the advance credit. Eligibility for an advance credit would be based on an individual's prior year tax return. To qualify for the credit, a health insurance policy would have to include coverage for catastrophic medical expenses. Qualifying insurance could be purchased in the individual market. Qualifying health insurance could also be purchased through private purchasing groups, State-sponsored insurance purchasing pools, and high-risk pools. Such groups may help reduce health insurance costs and increase coverage options for individuals, including older and higher-risk individuals. Individuals would not be allowed to claim the credit and make a contribution to a Health Savings Account (HSA) or Archer MSA for the same taxable year.

Provide an above-the-line deduction for high-deductible insurance premiums.—Current law provides a tax preference for employer-provided health insurance. Current law also provides that individuals may make tax-deductible contributions to Health Savings Accounts (HSAs) if certain criteria are met, including the individual being covered by a high-deductible health insurance plan. Individuals may then make tax-free withdrawals from their HSAs for qualified, health-care related out-of-pocket expenses. Individuals who do not have employer-provided health insurance may also make tax-deductible contributions to HSAs, but the premiums from their high-deductible insurance plan are not tax-deductible. The Administration proposes to allow all individuals an above-the-line deduction for insurance premiums arising from high-deductible health insurance plans if the plan qualifies the individual for an HSA and if the individual does not have employer-provided coverage. This proposal generally eliminates the unequal tax treatment of high-deductible insurance premiums between individuals who have employer-provided health care and those who do not, and further increases the attractiveness of HSAs in general. The deduction would be effective for taxable years beginning after December 31, 2004.

Provide an above-the-line deduction for long-term care insurance premiums.—Current law provides a tax preference for employer-paid long-term care insurance. However, the vast majority of the long-term care insurance market consists of individually purchased policies, for which no tax preference is provided except to the extent that deductible medical expenses exceed 7.5 percent of AGI or the individual has self-employment income. Premiums on qualified long-term care insurance are deductible as a medical expense, subject to annual dollar limitations that increase with age. The Administration proposes to make individually-purchased long-term care insurance more affordable by creating an above-the-line deduction for qualified long-term care insurance premiums. The Secretary of the Treasury would be authorized to require long-term care insurance to meet consumer protection standards for quality coverage. The deduction would be available to taxpayers who individually purchase qualified long-term care insurance and to those who pay at least 50 percent of the cost of employer-provided coverage. The deduction would be effective for taxable years beginning after December 31, 2004 but it would be phased in over four years. The deduction would be subject to current law annual dollar limitations on qualified long-term care insurance premiums.

Provide an additional personal exemption to home caregivers of family members.—Current law provides a tax deduction for certain long-term care expenses. In addition, taxpayers are allowed to claim exemptions for themselves (and their spouses, if married) and dependents who they support. However, neither provision may meet the needs of taxpayers who provide long-term care in their own home for close family members. Effective for taxable years beginning after December 31, 2004, the Administration proposes to provide an additional personal exemption to taxpayers who care for certain qualified family members who reside with the taxpayer in the household maintained by the taxpayer. A taxpayer is considered to maintain a household only if he or she furnishes over half of the annual cost of maintaining the household. Qualified family members would include any individual with long-term care needs who is (1) the spouse of the taxpayer or an ancestor of the taxpayer or the spouse of such an ancestor and (2) a member of the taxpayer's household for the entire year. An individual would be considered to have long-term care needs if he or she were certified by a licensed physician (prior to the filing of a return claiming the exemption) as, for at least 180 consecutive days, unable to perform at least two activities of daily living without substantial assistance from another individual due to a loss of functional capacity; or, alternatively, (1) requiring substantial supervision to be protected from threats to his or her own health and safety due to severe cognitive impairment and (2) being unable to perform at least one activity of daily living or being unable to engage in age appropriate activities.

Allow the orphan drug tax credit for certain pre-designation expenses.—Current law provides a 50-percent credit for expenses related to human clinical testing of drugs for the treatment of certain rare diseases and conditions ("orphan drugs"). A taxpayer may claim the credit only for expenses incurred after the Food and Drug Administration (FDA) designates a drug as a potential treatment for a rare disease or condition. This creates an incentive to defer clinical testing for orphan drugs until the taxpayer receives the FDA's approval and increases complexity for taxpayers by treating pre-designation and post-designation clinical expenses differently. The Administration proposes to allow taxpayers to claim the orphan drug credit for expenses incurred prior to FDA designation if designation occurs before the due date (including extensions) for filing the tax return for the year in which the FDA application was filed. The proposal would be effective for qualified expenses incurred after December 31, 2003.

Clarity the Health Coverage Tax Credit.—The Health Coverage Tax Credit (HCTC) was created under the Trade Adjustment Assistance (TAA) Reform Act of 2002 for the purchase of qualified health insurance. Eligible persons include certain individuals who are receiving benefits under the TAA or the Alternative TAA (ATAA) program and certain individuals between the ages of 55 and 64 who are receiving pension benefits from the Pension Benefit Guaranty Corporation (PBGC). The tax credit is refundable and can be claimed through an advance payment mechanism at the time the insurance is purchased. To clarify the statute and reduce administrative complexity, the Administration proposes the following changes: (1) Modify the definition of "other specified coverage" for "eligible ATAA recipients" to be the same as the definition applied to other eligible individuals; (2) clarify that certain PBGC pension recipients are eligible for the tax credit; (3) allow State-based continuation coverage to qualify without meeting the requirements for State-based qualified coverage; (4) for purposes of the State-based coverage rules, permit Commonwealths of Puerto Rico and Northern Mariana Islands, as well as American Samoa, Guam, and the U.S. Virgin Islands to be deemed as States; and (5) clarify the application of the confidentiality and disclosure rules to the administration of the advance credit.

Provide Incentives for Charitable Giving

Provide charitable contribution deduction for nonitemizers.—Under current law, individual taxpayers who do not itemize their deductions (nonitemizers) are not able to deduct contributions to qualified charitable organizations. The Administration proposes to allow nonitemizers to deduct charitable contributions of cash in addition to claiming the standard deduction, effective for taxable years beginning after December 31, 2003. Nonitemizers would be allowed to deduct cash contributions that exceed $250 ($500 for married taxpayers filing jointly), up to a maximum deduction of $250 ($500 for married taxpayers filing jointly). The deduction floor and limits would be indexed for inflation after 2004. Deductible contributions would be subject to existing rules governing itemized charitable contributions, such as the substantiation requirements.

Permit tax-free withdrawals from IRAs for charitable contributions.—Under current law, eligible individuals may make deductible or non-deductible contributions to a traditional IRA. Pre-tax contributions and earnings in a traditional IRA are included in income when withdrawn. Effective for distributions after date of enactment, the Administration proposes to allow individuals who have attained age 65 to exclude from gross income IRA distributions made directly to a charitable organization. The exclusion would apply without regard to the percentage-of-AGI limitations that apply to deductible charitable contributions. The exclusion would apply only to the extent the individual receives no return benefit in exchange for the transfer, and no charitable deduction would be allowed with respect to any amount that is excludable from income under this provision.

Expand and increase the enhanced charitable deduction for contributions of food inventory.—A taxpayer's deduction for charitable contributions of inventory generally is limited to the taxpayer's basis (typically cost) in the inventory. However, for certain contributions of inventory, C corporations may claim an enhanced deduction equal to the lesser of: (1) basis plus one half of the fair market value in excess of basis, or (2) two times basis. To be eligible for the enhanced deduction, the contributed property generally must be inventory of the taxpayer contributed to a charitable organization and the donee must (1) use the property consistent with the donee's exempt purpose solely for the care of the ill, the needy, or infants, (2) not transfer the property in exchange for money, other property, or services, and (3) provide the taxpayer a written statement that the donee's use of the property will be consistent with such requirements. To use the enhanced deduction, the taxpayer must establish that the fair market value of the donated item exceeds basis.

Under the Administration's proposal, which is designed to encourage contributions of food inventory to charitable organizations, any taxpayer engaged in a trade or business would be eligible to claim an enhanced deduction for donations of food inventory. The enhanced deduction for donations of food inventory would be increased to the lesser of: (1) fair market value, or (2) two times basis. However, to ensure consistent treatment of all businesses claiming an enhanced deduction for donations of food inventory, the enhanced deduction for qualified food donations by S corporations and non-corporate taxpayers would be limited to 10 percent of net income from the trade or business. A special provision would allow taxpayers with a zero or low basis in the qualified food donation (e.g., taxpayers that use the cash method of accounting for purchases and sales, and taxpayers that are not required to capitalize indirect costs) to assume a basis equal to 25 percent of fair market value. The enhanced deduction would be available only for donations of "apparently wholesome food" (food intended for human consumption that meets all quality and labeling standards imposed by Federal, state, and local laws and regulations, even though the food may not be readily marketable due to appearance, age, freshness, grade, size, surplus, or other conditions). The fair market value of "apparently wholesome food" that cannot or will not be sold solely due to internal standards of the taxpayer or lack of market, would be determined by taking into account the price at which the same or substantially the same food items (as to both type and quality) are sold by the taxpayer at the time of the contribution or, if not sold at such time, in the recent past. These proposed changes in the enhanced deduction for donations of food inventory would be effective for taxable years beginning after December 31, 2003.

Reform excise tax based on investment income of private foundations.—Under current law, private foundations that are exempt from Federal income tax are subject to a two-percent excise tax on their net investment income (one-percent if certain requirements are met). The excise tax on private foundations that are not exempt from Federal income tax, such as certain charitable trusts, is equal to the excess of the sum of the excise tax that would have been imposed if the foundation were tax exempt and the amount of the unrelated business income tax that would have been imposed if the foundation were tax exempt, over the income tax imposed on the foundation. To encourage increased charitable activity and simplify the tax laws, the Administration proposes to replace the two rates of tax on the net investment income of private foundations that are exempt from Federal income tax with a single tax rate of one percent. The excise tax on private foundations not exempt from Federal income tax would be equal to the excess of the sum of the one-percent excise tax that would have been imposed if the foundation were tax exempt and the amount of the unrelated business income tax what would have been imposed if the foundation were tax exempt, over the income tax imposed on the foundation. The proposed change would be effective for taxable years beginning after December 31, 2003.

Modify tax on unrelated business taxable income of charitable remainder trusts.—A charitable remainder annuity trust is a trust that is required to pay, at least annually, a fixed dollar amount of at least five percent of the initial value of the trust to a non-charity for the life of an individual or for a period of 20 years or less, with the remainder passing to charity. A charitable remainder unitrust is a trust that generally is required to pay, at least annually, a fixed percentage of at least five percent of the fair market value of the trust's assets determined at least annually to a non-charity for the life of an individual or for a period of 20 years or less, with the remainder passing to charity. A trust does not qualify as a charitable remainder annuity trust if the annuity for a year is greater than 50 percent of the initial fair market value of the trust's assets. A trust does not qualify as a charitable remainder unitrust if the percentage of assets that are required to be distributed at least annually is greater than 50 percent. A trust does not qualify as a charitable remainder annuity trust or a charitable remainder unitrust unless the value of the remainder interest in the trust is at least 10 percent of the value of the assets contributed to the trust. Distributions from a charitable remainder annuity trust or charitable remainder unitrust, which are included in the income of the beneficiary for the year that the amount is required to be distributed, are treated in the following order as: (1) ordinary income to the extent of the trust's current and previously undistributed ordinary income for the trust's year in which the distribution occurred, (2) capital gains to the extent of the trust's current capital gain and previously undistributed capital gain for the trust's year in which the distribution occurred, (3) other income to the extent of the trust's current and previously undistributed other income for the trust's year in which the distribution occurred, and (4) corpus (trust principal).

Charitable remainder annuity trusts and charitable remainder unitrusts are exempt from Federal income tax; however, such trusts lose their income tax exemption for any year in which they have unrelated business taxable income. Any taxes imposed on the trust are required to be allocated to trust corpus. The Administration proposes to levy a 100-percent excise tax on the unrelated business taxable income of charitable remainder trusts, in lieu of removing the Federal income tax exemption for any year in which unrelated business taxable income is incurred. This change, which is a more appropriate remedy than loss of tax exemption, is proposed to become effective for taxable years beginning after December 31, 2003, regardless of when the trust was created.

Modify basis adjustment to stock of S corporations contributing appreciated property.—Under current law, each shareholder in an S corporation separately accounts for his or her pro rata share of the S corporation's charitable contributions in determining his or her income tax liability. A shareholder's basis in the stock of the S corporation must be reduced by the amount of his or her pro rata share of the S corporation's charitable contribution. In order to preserve the benefit of providing a charitable contribution deduction for contributions of appreciated property and to prevent the recognition of gain on the contributed property on the disposition of the S corporation stock, the Administration proposes to allow a shareholder in an S corporation to increase his or her basis in the stock of an S corporation by an amount equal to the excess of the shareholder's pro rata share of the S corporation's charitable contribution over the stockholder's pro rata share of the adjusted basis of the contributed property. The proposal would be effective for taxable years beginning after December 31, 2003.

Repeal the $150 million limitation on qualified 501(c)(3) bonds.—Current law contains a $150 million limitation on the volume of outstanding, non-hospital, tax-exempt bonds for the benefit of any one 501(c)(3) organization. The limitation was repealed in 1997 for bonds issued after August 5, 1997, at least 95 percent of the net proceeds of which are used to finance capital expenditures incurred after that date. However, the limitation continues to apply to bonds more than five percent of the net proceeds of which finance or refinance working capital expenditures, or capital expenditures incurred on or before August 5, 1997. In order to simplify the tax laws and provide consistent treatment of bonds for 501(c)(3) organizations, the Administration proposes to repeal the $150 million limitation in its entirety.

Repeal certain restrictions on the use of qualified 501(c)(3) bonds for residential rental property.—Tax-exempt, 501(c)(3) organizations generally may utilize tax-exempt financing for charitable purposes. However, existing law contains a special limitation under which 501(c)(3) organizations may not use tax-exempt financing to acquire existing residential rental property for charitable purposes unless the property is rented to low-income tenants or is substantially rehabilitated. In order to simplify the tax laws and provide consistent treatment of bonds for 501(c)(3) organizations, the Administration proposes to repeal the residential rental property limitation.

Strengthen Education

Extend, increase, and expand the above-the-line deduction for qualified out-of-pocket classroom expenses.—Under recently expired law, teachers who itemize deductions (do not use the standard deduction) and incur unreimbursed, job-related expenses were allowed to deduct those expenses to the extent that when combined with other miscellaneous itemized deductions they exceeded two percent of AGI. Prior law also allowed certain teachers and other elementary and secondary school professionals to treat up to $250 in annual qualified out-of-pocket classroom expenses as a non-itemized deduction (above-the-line deduction), effective for expenses incurred in taxable years beginning after December 31, 2001 and before January 1, 2004. Unreimbursed expenditures for certain books, supplies and equipment related to classroom instruction qualified for the above-the-line deduction. Expenses claimed as an above-the-line deduction could not be claimed as an itemized deduction. The Administration proposes to extend the above-the-line deduction to apply to qualified out-of-pocket expenditures incurred after December 31, 2003, to increase the deduction to $400, and to expand the deduction to apply to unreimbursed expenditures for certain professional training programs.

Encourage Telecommuting

Exclude from income the value of employer-provided computers, software, and peripherals.—Under current law, the value of computers and related equipment and services provided by an employer to an employee for home use is generally allocated between business and personal use. The business-use portion is excluded from the employee's income whereas the personal-use portion is subject to income and payroll taxes. In order to simplify recordkeeping, improve compliance, and encourage telecommuting, the Administration proposes to allow individuals to exclude from income the value of employer-provided computers and related equipment and services necessary to perform work for the employer at home. The employee would be required to make substantial use of the equipment to perform work for the employer. Substantial business use would include standby use for periods when work from home may be required by the employer, such as during work closures caused by the threat of terrorism, inclement weather, or natural disasters. The proposal would be effective for taxable years beginning after December 31, 2004.

Increase Housing Opportunities

Provide tax credit for developers of affordable single-family housing.—The Administration proposes to provide annual tax credit authority to states (including U.S. possessions) designed to promote the development of affordable single-family housing in low-income urban and rural neighborhoods. Beginning in calendar year 2005, first-year credit authority equal to the amount provided for low-income rental housing tax credits would be made available to each state. That amount is equal to the greater of $2 million or $1.75 per capita (indexed annually for inflation after 2002). State housing agencies would award first-year credits to single-family housing units comprising a project located in a census tract with median income equal to 80 percent or less of area median income. Units in condominiums and cooperatives could qualify as single-family housing. Credits would be awarded as a fixed amount for individual units comprising a project. The present value of the credits, determined on the date of a qualifying sale, could not exceed 50 percent of the cost of constructing a new home or rehabilitating an existing property. The taxpayer (developer or investor partnership) owning the housing unit immediately prior to the sale to a qualified buyer would be eligible to claim credits over a five-year period beginning on the date of sale. Eligible homebuyers would be required to have incomes equal to 80 percent or less of area median income. Certain technical features of the provision would follow similar features of current law with respect to the low-income housing tax credit and mortgage revenue bonds.

Protect the Environment

Extend permanently expensing of brownfields remediation costs.—Taxpayers may elect, with respect to expenditures paid or incurred before January 1, 2004, to treat certain environmental remediation expenditures that would otherwise be chargeable to capital account as deductible in the year paid or incurred. The Administration proposes to extend this provision permanently for expenditures paid or incurred after December 31, 2003, facilitating its use by businesses to undertake projects that may be uncertain in overall duration.

Exclude 50 percent of gains from the sale of property for conservation purposes.—The Administration proposes to create a new incentive for private, voluntary land protection. This incentive is a cost-effective, non-regulatory approach to conservation. Under the proposal, when land (or an interest in land or water) is sold for conservation purposes, only 50 percent of any gain would be included in the seller's income.

This proposal applies to conservation easements and similar sales of partial interests in land, such as development rights and agricultural conservation easements, for conservation purposes. To be eligible for the exclusion, the sale may be either to a government agency or to a qualified conservation organization, and the buyer must supply a letter of intent that the acquisition will serve conservation purposes. In addition, the taxpayer or a member of the taxpayer's family must have owned the property for the three years immediately preceding the sale. Antiabuse provisions will ensure that the conservation purposes continue to be served. The provision would be effective for sales taking place after December 31, 2004 and before January 1, 2008.

Increase Energy Production and Promote Energy Conservation

Extend and modify the tax credit for producing electricity from certain sources.—Taxpayers are provided a 1.5-cent-per-kilowatt-hour tax credit, adjusted for inflation after 1992, for electricity produced from wind, closed-loop biomass (organic material from a plant grown exclusively for use at a qualified facility to produce electricity), and poultry waste. To qualify for the credit, the electricity must be sold to an unrelated third party and must be produced during the first 10 years of production at a facility placed in service before January 1, 2004. The Administration proposes to extend the credit for electricity produced from wind and biomass to facilities placed in service before January 1, 2007. In addition, eligible biomass sources would be expanded to include certain biomass from forest-related resources, agricultural sources, and other specified sources. Special rules would apply to biomass facilities placed in service before January 1, 2004. Electricity produced at such facilities from newly eligible sources would be eligible for the credit only from January 1, 2004 through December 31, 2008, and at a rate equal to 60 percent of the generally applicable rate. Electricity produced from newly eligible biomass co-fired in coal plants would also be eligible for the credit only from January 1, 2004 through December 31, 2006, and at a rate equal to 30 percent of the generally applicable rate. The Administration also proposes to modify the rules relating to governmental financing of qualified facilities. There would be no percentage reduction in the credit for governmental financing attributable to tax-exempt bonds. Instead, such financing would reduce the credit only to the extent necessary to offset the value of the tax exemption. The rules relating to leased facilities would also be modified to permit the lessee, rather than the owner, to claim the credit.

Provide tax credit for residential solar energy systems.—Current law provides a 10-percent investment tax credit to businesses for qualifying equipment that uses solar energy to generate electricity; to heat, cool or provide hot water for use in a structure; or to provide solar process heat. A credit currently is not provided for nonbusiness purchases of solar energy equipment. The Administration proposes a new tax credit for individuals who purchase solar energy equipment to generate electricity (photovoltaic equipment) or heat water (solar water heating equipment) for use in a dwelling unit that the individual uses as a residence, provided the equipment is used exclusively for purposes other than heating swimming pools. The proposed nonrefundable credit would be equal to 15 percent of the cost of the equipment and its installation; each individual taxpayer would be allowed a maximum credit of $2,000 for photovoltaic equipment and $2,000 for solar water heating equipment. The credit would apply to photovoltaic equipment placed in service after December 31, 2003 and before January 1, 2009 and to solar water heating equipment placed in service after December 31, 2003 and before January 1, 2007.

Modify treatment of nuclear decommissioning funds.—Under current law, deductible contributions to nuclear decommissioning funds are limited to the amount included in the taxpayer's cost of service for ratemaking purposes. For deregulated utilities, this limitation may result in the denial of any deduction for contributions to a nuclear decommissioning fund. The Administration proposes to repeal this limitation.

Also under current law, deductible contributions are not permitted to exceed the amount the IRS determines to be necessary to provide for level funding of an amount equal to the taxpayer's post-1983 decommissioning costs. The Administration proposes to permit funding of all decommissioning costs through deductible contributions. Any portion of these additional contributions relating to pre-1984 costs that exceeds the amount previously deducted (other than under the nuclear decommissioning fund rules) or excluded from the taxpayer's gross income on account of the taxpayer's liability for decommissioning costs, would be allowed as a deduction ratably over the remaining useful life of the nuclear power plant.

The Administration's proposal would also permit taxpayers to make deductible contributions to a qualified fund after the end of the nuclear power plant's estimated useful life and would provide that nuclear decommissioning costs are deductible when paid. These changes in the treatment of nuclear decommissioning funds are proposed to be effective for taxable years beginning after December 31, 2003.

Provide tax credit for purchase of certain hybrid and fuel cell vehicles.—Under current law, a 10-percent tax credit up to $4,000 is provided for the cost of a qualified electric vehicle. The full amount of the credit is available for purchases prior to 2004. The credit begins to phase down in 2004 and is not available after 2006. A qualified electric vehicle is a motor vehicle that is powered primarily by an electric motor drawing current from rechargeable batteries, fuel cells, or other portable sources of electric current, the original use of which commences with the taxpayer, and that is acquired for use by the taxpayer and not for resale. Electric vehicles and hybrid vehicles (those that have more than one source of power on board the vehicle) have the potential to reduce petroleum consumption, air pollution and greenhouse gas emissions. To encourage the purchase of such vehicles, the Administration is proposing the following tax credits: (1) A credit of up to $4,000 would be provided for the purchase of qualified hybrid vehicles after December 31, 2003 and before January 1, 2009. The amount of the credit would depend on the percentage of maximum available power provided by the rechargeable energy storage system and the amount by which the vehicle's fuel economy exceeds the 2000 model year city fuel economy. (2) A credit of up to $8,000 would be provided for the purchase of new qualified fuel cell vehicles after December 31, 2003 and before January 1, 2013. A minimum credit of $4,000 would be provided, which would increase as the vehicle's fuel efficiency exceeded the 2000 model year city fuel economy, reaching a maximum credit of $8,000 if the vehicle achieved at least 300 percent of the 2000 model year city fuel economy.

Provide tax credit for energy produced from landfill gas.—Taxpayers that produce gas from biomass (including landfill methane) are eligible for a tax credit equal to $3 per barrel-of-oil equivalent (the amount of gas that has a British thermal unit content of 5.8 million), adjusted by an inflation adjustment factor for the calendar year in which the sale occurs. To qualify for the credit, the gas must be produced domestically from a facility placed in service by the taxpayer before July 1, 1998, pursuant to a written binding contract in effect before January 1, 1997. In addition, the gas must be sold to an unrelated person before January 1, 2008. The Administration proposes to extend the credit to apply to landfill methane produced from a facility (or portion of a facility) placed in service after December 31, 2003 and before January 1, 2012, and sold (or used to produce electricity that is sold) before January 1, 2012. The credit for fuel produced at landfills subject to EPA's 1996 New Source Performance Standards/Emissions Guidelines would be limited to two-thirds of the otherwise applicable amount beginning on January 1, 2008, if any portion of the facility for producing fuel at the landfill was placed in service before July 1, 1998, and beginning on January 1, 2004, in all other cases.

Provide tax credit for combined heat and power property.—Combined heat and power (CHP) systems are used to produce electricity (and/or mechanical power) and usable thermal energy from a single primary energy source. Depreciation allowances for CHP property vary by asset use and capacity. No income tax credit is provided under current law for investment in CHP property. CHP systems utilize thermal energy that is otherwise wasted in producing electricity by more conventional methods and achieve a greater level of overall energy efficiency, thereby lessening the consumption of primary fossil fuels, lowering total energy costs, and reducing carbon emissions. To encourage increased energy efficiency by accelerating planned investments and inducing additional investments in such systems, the Administration is proposing a 10-percent investment credit for qualified CHP systems with an electrical capacity in excess of 50 kilowatts or with a capacity to produce mechanical power in excess of 67 horsepower (or an equivalent combination of electrical and mechanical energy capacities). A qualified CHP system would be required to produce at least 20 percent of its total useful energy in the form of thermal energy and at least 20 percent of its total useful energy in the form of electrical or mechanical power (or a combination thereof) and would also be required to satisfy an energy-efficiency standard. For CHP systems with an electrical capacity in excess of 50 megawatts (or a mechanical energy capacity in excess of 67,000 horsepower), the total energy efficiency would have to exceed 70 percent. For smaller systems, the total energy efficiency would have to exceed 60 percent. Investments in qualified CHP assets that are otherwise assigned cost recovery periods of less than 15 years would be eligible for the credit, provided that the taxpayer elects to treat such property as having a 22-year class life (and thus depreciates the property using a 15-year recovery period). The credit, which would be treated as an energy credit under the investment credit component of the general business credit, and could not be used in conjunction with any other credit for the same equipment, would apply to investments in CHP property placed in service after December 31, 2003 and before January 1, 2009.

Extend excise tax exemption (credit) for ethanol.—Under current law an income tax credit and an excise tax exemption are provided for ethanol and renewable source methanol used as a fuel. In general, the income tax credit for ethanol is 52 cents per gallon, but small ethanol producers (those producing less than 30 million gallons of ethanol per year) qualify for a credit of 62 cents per gallon on the first 15 million gallons of ethanol produced in a year. A credit of 60 cents per gallon is allowed for renewable source methanol. As an alternative to the income tax credit, gasohol blenders may claim a gasoline tax exemption of 52 cents for each gallon of ethanol and 60 cents for each gallon of renewable source methanol that is blended into qualifying gasohol. The rates for the ethanol credit and exemption are each reduced by 1 cent per gallon in 2005. The income tax credit expires on December 31, 2007 and the excise tax exemption expires on September 30, 2007. Neither the credit nor the exemption apply during any period in which motor fuel taxes dedicated to the Highway Trust Fund are limited to 4.3 cents per gallon. The Administration proposes to extend both the income tax credit and the excise tax exemption through December 31, 2010. The current law rule providing that neither the credit nor the exemption apply during any period in which motor fuel taxes dedicated to the Highway Trust Fund are limited to 4.3 cents per gallon would be retained.

Permit electric utilities to defer gain from sales of electric transmission property.—Under current law, gain on the sale of business assets is subject to current income tax unless a special rule provides for nonrecognition or deferral of the gain. To encourage restructuring of the electric industry, the Administration proposes to permit electric utilities to defer the gain from sales of electric transmission property (or an ownership interest in an entity providing electric transmission services) to an independent transmission company. For this purpose, an independent transmission company would include any regional transmission organization, independent system operator, or independent transmission company approved by the Federal Energy Regulatory Commission (FERC) and certain other persons that place their transmission facilities under the control of such a FERC-approved transmission provider. (Similar rules would apply in determining whether a sale of facilities subject to the jurisdiction of the Texas Public Utility Commission qualifies for deferral.) A taxpayer electing deferral under the proposal would recognize the gain ratably over the eight-year period beginning with the year of sale. Deferral would be available only to the extent the taxpayer (or an affiliate) reinvests the amount received for the transmission property in other electric or gas utility property. The proposal would apply to sales or other dispositions occurring after the date of enactment and before January 1, 2007.

Modify tax treatment of certain income of electric cooperatives.—Mutual or cooperative electric companies (electric cooperatives) generally are exempt from Federal income tax if at least 85 percent of the cooperative's income consists of amounts collected from members for the sole purpose of meeting losses and expenses (the 85-percent test). Taxable electric cooperatives may exclude from taxable income certain profits rebated to patrons. To encourage participation by electric cooperatives in electric industry restructuring, the Administration proposes that income from the following activities be excluded from the 85-percent test: (1) providing open access transmission service under a tariff filed with FERC (or, if applicable, the Public Utility Commission of Texas) or an independent transmission provider agreement approved or accepted by FERC (or, if applicable, the Public Utility Commission of Texas); (2) providing open access distribution service to end-users served by distribution facilities not owned by the cooperative or any of its members, or to third parties to deliver electric energy generated by a facility not owned or leased by the cooperative or any of its members if the facility is directly connected to distribution facilities owned by the cooperative or any of its members; (3) certain transfers into (and distributions and earnings from) a trust, fund or instrument established to pay nuclear decommissioning costs; and (4) certain voluntary exchanges or involuntary conversions of property related to generating, transmitting, distributing or selling electric energy. The Administration also proposes that income from sales of electric energy to nonmembers be treated as qualifying member income (and, in the case of certain taxable electric cooperatives, excluded from taxable income whether or not profits are rebated to patrons) to the extent such sales do not exceed the cooperative's load losses during a specified ten-year recovery period.

SIMPLIFY THE TAX LAWS FOR FAMILIES

Establish uniform definition of a qualifying child.—The tax code provides assistance to families with children through the dependent exemption, head-of-household filing status, child tax credit, child and dependent care tax credit, and earned income tax credit (EITC). However, because each provision defines an eligible "child" differently, taxpayers must wade through pages of bewildering rules and instructions, resulting in confusion and error. The Administration proposes to harmonize the definition of qualifying child across these five related tax benefits, thereby reducing both compliance and administrative costs. Under the Administration's proposal, a qualifying child must meet the following three tests: (1) Relationship—The child must be the taxpayer's biological or adopted child, stepchild, sibling, or step-sibling, a descendant of one of these individuals, or a foster child. (2) Residence—The child must live with the taxpayer in the same principal home in the United States for more than half of the year. (3) Age—The child must be under age 19, a full-time student if over 18 and under 24, or totally and permanently disabled. Neither the support nor gross income tests of current law would apply to qualifying children who meet these three tests. In addition, taxpayers would no longer be required to meet a household maintenance test when claiming the child and dependent care tax credit. Current law requirements that a child be under age 13 for the dependent care credit and under age 17 for the child tax credit, would be maintained. Taxpayers generally could continue to claim individuals who do not meet the proposed relationship, residency, or age tests as dependents if they meet the requirements under current law, and no other taxpayer claims the same individual. The proposal would be effective for tax years beginning after December 31, 2004.

Simplify adoption tax benefits.—Under current law, for taxable years beginning before January 1, 2011, the following tax benefits are provided to taxpayers who adopt children: (1) a nonrefundable tax credit for qualified expenses incurred in the adoption of a child, up to a certain limit, and (2) the exclusion from gross income of qualified adoption expenses paid or reimbursed by an employer under an adoption assistance program, up to a certain limit. Taxpayers may not claim the credit for expenses that are excluded from gross income. In 2004, the limitation on qualified adoption expenses for both the credit and the exclusion is $10,390. Taxpayers who adopt children with special needs may claim the full $10,390 credit or exclusion even if adoption expenses are less than this amount. Taxpayers may carry forward unused credit amounts for up to five years. When modified adjusted gross income exceeds $155,860 (in 2004), both the credit amount and the amount excluded from gross income are reduced pro-rata over the next $40,000 of modified adjusted gross income. The maximum credit and exclusion and the income at which the phase-out range begins are indexed annually for inflation. For taxable years beginning after December 31, 2010, taxpayers will be able to claim the credit only for actual expenses for the adoption of children with special needs. For these taxpayers the qualified expense limit will be $6,000, the credit will be reduced pro-rata between $75,000 and $115,000 of modified adjusted gross income, and the credit amount and phase-out range will not be indexed annually for inflation. Taxpayers may not exclude employer-provided adoption assistance from gross income for taxable years beginning after December 31, 2010.

To reduce marginal tax rates and simplify computations of tax liabilities, the Administration is proposing to eliminate the income-related phaseout of the adoption tax credit and exclusion. The proposal would be effective for taxable years beginning after December 31, 2004. The phaseout of adoption tax benefits increases complexity for all taxpayers using the adoption tax provisions, including the vast majority who are not affected by the phaseouts; raises marginal tax rates for taxpayers in the phase-out range; and with the higher phase-out income levels under the 2001 tax cut, affects fewer than 10,000 taxpayers. The broader eligibility criteria, larger qualifying expense limitations, and the employer exclusion would apply in taxable years beginning after December 31, 2010 as a result of the Administration's proposal to extend the 2001 tax cut provisions permanently.

Eliminate household maintenance test for head-of-household filing status—Unmarried taxpayers who reside with children may qualify as heads of household or surviving spouses, which entitles them to a more generous standard deduction and rate structure than other unmarried filers. To qualify for the more generous provisions, the taxpayer must provide over half the costs of maintaining the household. The "household maintenance test" imposes a significant record-keeping burden on taxpayers (who must keep receipts for expenditures on food, shelter, utilities, etc.), and it is a difficult test for the IRS to administer. Under the proposal, unmarried taxpayers who live with children or other related dependents could qualify as heads of household even if they do not provide over half the costs of maintaining their home. Similarly, recently widowed taxpayers who live with their children would not have to meet the complicated household maintenance test in order to file as surviving spouses. The proposal would be effective for taxable years beginning after December 31, 2004.

Reduce computational complexity of refundable child tax credit.—Taxpayers with earned income in excess of $10,750 may qualify for a refundable (or "additional") child tax credit even if they do not have any income tax liability. About seventy-five percent of additional child tax credit claimants also claim the EITC. However, the two credits have a different definition of earned income and different U.S. residency requirements. In addition, some taxpayers have to perform multiple computations to determine the amount of the additional child tax credit they can claim. First, they must compute the additional child tax credit using a formula based on earned income. Then, if they have three or more children, they may recalculate the credit using a formula based on social security taxes and claim the higher of the two amounts.

Under the proposal, the additional child tax credit would use the same definition of earned income as is used for the EITC. Taxpayers (other than members of the Armed Forces stationed overseas) would be required to reside with a child in the United States to claim the additional child tax credit (as they are currently required to do for the EITC). Taxpayers with three or more children would do only one computation based on earned income to determine the credit amount. The proposal would be effective for taxable years beginning after December 31, 2004.

Simplify EITC eligibility requirements regarding filing status, presence of children, investment income, and work and immigration status.—To qualify for the EITC, taxpayers must satisfy requirements regarding filing status, the presence of children in their households, investment income, and their work and immigration status in the United States. These rules are confusing, require significant record-keeping, and are costly to administer. Under the proposal, married taxpayers who reside with children could claim the EITC without satisfying a complicated household maintenance test if they live apart from their spouse for the last six months of the year. In addition, certain taxpayers who live with children but do not qualify for the larger child-related EITC could claim the smaller EITC for very low-income childless workers. The proposal also eliminates the investment income test for taxpayers who are otherwise EITC eligible. The proposal would also improve the administration of the EITC with respect to eligibility requirements for undocumented workers. The proposal is effective for taxable years beginning after December 31, 2004.

Simplify the taxation of dependents (including minor children).—Under current law the standard deduction of taxpayers who may be claimed as dependents of another taxpayer is the lesser of (1) the standard deduction for single taxpayers ($4,850 for 2004, indexed annually); or (2) the larger of $800 (for 2004) or the individual's earned income plus $250 (for 2004). In addition, special rules (called the "kiddie tax") apply for minors under age 14 with taxable investment income. Only the first $800 (in 2004) of the child's taxable investment income over the standard deduction is taxed at the child's tax rate. Taxable investment income in excess of $800 is taxed as the marginal income of the parents (or guardian). In certain cases, the parents (or guardian) may elect to include the dependent's income on their own tax return. The proposal would simplify both the standard deduction for all dependents and the "kiddie tax" provisions for dependents under age 14. The standard deduction for dependent filers would be $800 (indexed after 2005) plus the amount of the dependent's earned income, not to exceed the standard deduction for a non-dependent single filer. For dependents under age 14, the first $2,500 (indexed after 2005) of taxable investment income and all earned income would be taxed at the child's own tax rate. Any taxable investment income above $2,500 would be taxed at the highest regular income tax rate (regardless of the parents' tax rate). Any capital gains included in taxable investment income above $2,500 would be taxed at the highest capital gains tax rate generally applicable. The election to include the child's investment income on the parents' tax return would be eliminated. Both proposals wold be effective for tax years beginning after December 31, 2004.

Consolidate rules for lifetime learning credit, Hope credit, and education expense deductions, and simplify other higher education provisions.— Current law allows up to $2,500 of interest on student loans to be deducted. The phase-out range for this provision is $50,000 to $65,000 of modified adjusted gross income (AGI) for single taxpayers ($100,000 to $130,000 for joint returns). Current law also allows up to $4,000 of qualifying higher education expenses to be deducted for single taxpayers whose AGI does not exceed $65,000 ($130,000 for joint returns). Taxpayers with higher AGI may deduct up to $2,000 of qualifying higher education expenses if their AGI does not exceed $80,000 ($160,00 for joint returns). The deduction for higher education expenses expires after 2005. For calendar year 2004, both the Hope credit and lifetime learning credit begin to phase out at $42,000 of modified AGI ($83,00 for joint returns). Taxpayers may claim the HOPE credit for more than one qualifying student. In contrast, the lifetime learning credit is applied on a per-taxpayer rather than a per-student basis.

Under the Administration's proposal the lifetime learning credit would be revised to subsume the deductions for student loan interest and qualified higher education expenses by allowing the credit on a per-student basis, treating up to $2,500 of interest on student loans as a qualified expense, raising the beginning of the phase-out range to $50,000 ($100,000 for joint returns) and reducing the otherwise allowed credits by 5 percent of the extent to which modified AGI exceeds the new AGI thresholds. The temporary, above-the-line deduction for higher education expenses and the deduction for student loan interest would be repealed. The dollar limits of the revised lifetime learning credit and the Hope credit would be indexed. The phase-out rules for the Hope credit would be conformed to those of the revised lifetime learning credit.

The definition of qualified higher education expenses and qualified higher education institution would be made uniform by extending the definitions currently used in connection with Hope and lifetime learning credits and tuition deductions to other provisions of the IRS Code related to higher education. The definition of "special needs services," as referenced under current law with regard to distributions from Coverdell education savings accounts and qualified tuition programs, would be clarified. The exclusion from income for scholarships and fellowships would be clarified by reference to the allowance for books, supplies, and equipment included in an institution's cost of attendance for student aid purposes. The current-law phaseout of the maximum contribution that can be made to a Coverdell education savings account would be repealed.

Allow annual reporting and payment of combined State and Federal unemployment insurance taxes by employers of household employees.—Employers of household employees must separately pay Federal and State unemployment insurance for their employees. Because it is burdensome for employers of household employees to report and pay these taxes separately, the wages of household employees are often improperly reported. The Administration proposes to reduce this burden by requiring that employers of household employees annually report and pay a combined Federal and State unemployment tax to the Federal government. This would also reduce the administrative costs incurred by State unemployment insurance agencies, which are currently very large relative to the taxes collected and are ultimately borne by the Federal government. Unemployment benefits for household employees would continue to be paid by the States and reimbursed by the Federal government.

Simplify taxation of capital gains on collectibles, small business stock, and other assets.— Under current law, special tax rates apply to certain capital gains. Unrecaptured Section 1250 gains, which represent the portion of gain on real property previously deducted as straight-line depreciation, are taxed at ordinary rates up to a maximum rate of 25 percent. Collectibles are taxed at ordinary rates with a maximum rate of 28 percent. Gains from the sale of certain small business stock qualify for a 50-percent exclusion subject to a 28 percent maximum rate, resulting in a maximum effective rate of 14 percent (Section 1202). Subject to certain requirements, gains on small business stock can be deferred if the proceeds of the sale are re-invested in other small business stock (Section 1045). Schedule D and the associated forms and instructions are more complicated than necessary because of these special rates that apply in only a small fraction of cases. The Administration proposal would simplify capital gains tax provisions so as to allow all gains to be taxed at the basic capital gains or ordinary tax rates. Under the proposal, 50 percent of capital gains on collectibles would be taxed as short-term gains and the other 50 percent would be taxed as long-term gains. In addition, 50 percent of unrecaptured Section 1250 gains would be taxed as ordinary income and the other

50 percent would be taxed as long-term gains. The 50 percent exclusion for gain recognized on the sale of certain small business stock under section 1202 and the rollover of gain recognized on the sale of certain small business stock under section 1045 would be repealed. Modifying these three provisions would allow capital gains forms and instructions to be simplified, benefitting all taxpayers with capital gains. These provisions would be effective on the date of enactment.

STRENGTHEN THE EMPLOYER-BASED PENSION SYSTEM

Ensure fair treatment of older workers in cash balance conversions and protect defined benefit plans.—Qualified retirement plans consist of defined benefit plans and defined contribution plans. In recent years, many plan sponsors have adopted cash balance and other "hybrid" plans that combine features of defined benefit and defined contribution plans. A cash balance plan is a defined benefit plan that provides for annual "pay credits" to a participant's "hypothetical account" and "interest credits" on the balance in the hypothetical account. Questions have been raised about whether such plans satisfy the rules relating to age discrimination and the calculation of lump sum distributions. The Administration proposes to (1) ensure fairness for older workers in cash balance conversions, (2) protect the defined benefit system by clarifying the status of cash balance plans, and (3) remove the effective ceiling on interest credits in cash balance plans. All changes would be effective prospectively.

Improve the accuracy of pension liability measures.—Current law requires that employers use discount rates based on the interest rate on 30-year Treasury securities when making certain pension calculations. Use now of the 30-year Treasury bond interest rate artificially inflates pension liabilities and adversely affects employers offering defined benefit pension plans and working families who rely on the safe and secure benefits these plans provide. Effective for plan years beginning after December 31, 2003 and before January 1, 2006, the Administration proposes to replace the use of discount rates based on the interest rate on 30-year Treasury securities with a rate based on a composite of long-term corporate bond rates. Effective for plan years beginning after December 31, 2005, the Administration proposes to phase in the permanent use of a spot yield curve of high-grade corporate bonds to measure the value of pension liabilities and lump sums, with full implementation for plan years beginning after December 31, 2007. The yield curve is more accurate than any single rate because it ties pension-funding requirements to the timing of the payout of pension benefits. Additionally, the Administration proposes changes to restrict promises of added benefits by severely underfunded pension plans and to provide better information on pension finances to workers, retirees, and stockholders.

CLOSE LOOPHOLES AND IMPROVE TAX COMPLIANCE

Combat abusive tax avoidance transactions.—Although the vast majority of taxpayers and practitioners do their best to comply with the law, some actively promote or engage in transactions structured to generate tax benefits never intended by Congress. Such abusive transactions harm the public fisc, erode the public's respect for the tax laws, and consume limited IRS resources. The Administration has proposed a number of regulatory and legislative changes designed to significantly enhance the current enforcement regime and curtail the use of abusive tax avoidance transactions. These proposed changes include (1) the modification of the definition of a reportable transaction, (2) the issuance of a coordinated set of disclosure, registration, and investor list maintenance rules, (3) the imposition of new or increased penalties for the failure to disclose and register reportable transactions and for the failure to report an interest in a foreign financial account, (4) the prevention of "income separation" transactions structured to create immediate tax losses or to convert current ordinary income into deferred capital gain, and (5) the denial of foreign tax credits with respect to any foreign withholding taxes if the underlying property was not held for a specified minimum period of time as well as regulatory authority in order to prevent the inappropriate separation of foreign taxes from the related foreign income in cases where taxes are imposed on any person in respect of income of an entity. A number of administrative proposals already have been carried out by the Treasury Department and the IRS.

Limit related party interest deductions.—Current law (section 163(j) of the Internal Revenue Code) denies U.S. tax deductions for certain interest expenses paid to a related party where (1) the corporation's debt-to-equity ratio exceeds 1.5 to 1.0, and (2) net interest expenses exceed 50 percent of the corporation's adjusted taxable income (computed by adding back net interest expense, depreciation, amortization, depletion, and any net operating loss deduction). If these thresholds are exceeded, no deduction is allowed for interest in excess of the 50-percent limit that is paid to a related party or paid to an unrelated party but guaranteed by a related party, and that is not subject to U.S. tax. Any interest that is disallowed in a given year is carried forward indefinitely and may be deductible in a subsequent taxable year. A three-year carryforward for any excess limitation (the amount by which interest expense for a given year falls short of the 50-percent limit) is also allowed. Because of the opportunities available under current law to reduce inappropriately U.S. tax on income earned on U.S. operations through the use of foreign related-party debt, the Administration proposes to tighten the interest disallowance rules of section 163(j) as follows: (1) The current law 1.5 to 1 debt-to-equity safe harbor would be eliminated; (2) the adjusted taxable income threshold for the limitation would be reduced from 50 percent to 25 percent of adjusted taxable income with respect to disqualified interest other than interest paid to unrelated parties on debt that is subject to a related-party guarantee, which generally would remain subject to the current law 50 percent threshold; and (3) the indefinite carryforward for disallowed interest would be limited to ten years and the three-year carryforward of excess limitation would be eliminated.

Modify qualification rules for tax-exempt property-casualty insurance companies.—A property-casualty insurance company with $350,000 or less of annual premiums is exempt from tax. A company with annual premiums that exceed $350,000, but that do not exceed $1,200,000, may elect to be taxed only on its investment income. Premiums of companies that are members of the same controlled group (except for tax-exempt and foreign companies) are aggregated for making these determinations. The Department of Treasury has become aware that certain entities established as insurance companies have limited their premium receipts, claimed tax-exempt status, and are accumulating investment income tax-free. These actions represent a misuse of the tax-exemption and violate the original intent of the exemption, which was to assist small mutual insurers. The Administration proposes that the tax exemption for property-casualty insurance companies apply only to mutual property-casualty insurance companies with no more than $350,000 in annual gross income. In addition, the proposal would provide that tax exemption is available only for a domestic mutual property-casualty insurance company, which is organized within, and subject to regulation within, a single State, and which only writes insurance or reinsurance contracts on risks located within that same State. The proposal would also clarify the rules for determining whether a property-casualty insurance company is an insurance company for U.S. tax purposes, and would grant the Secretary of the Treasury discretion to develop appropriate reporting requirements to assure compliance with these rules. The election that allows a small property-casualty insurer to be taxed only on investment income would remain available to any property-casualty insurance company with annual premiums up to $1,200,000. For purposes of determining eligibility for these provisions, the proposal would aggregate amounts received by members of the same controlled group, including foreign and tax-exempt entities.

Increase penalties for false or fraudulent statements made to promote abusive tax avoidance transactions.—Under current law, a penalty is imposed if a person makes or furnishes a false or fraudulent statement in connection with promotion of an interest in a tax shelter. The amount of the penalty is the lesser of $1,000 or 100 percent of the gross income derived by the person from the organization, participation, or promotion of the tax shelter. This penalty amount is insufficient to deter tax shelter promoters from making false or fraudulent statement regarding the purported benefits of an abusive transaction. The Administration therefore proposes to increase the penalty to 50 percent (or $1,000, if greater) of the income derived by the person making or furnishing the false statement in connection with the promotion of a tax shelter.

Prevent abusive overvaluations on donations of patents and other intellectual property.—Under current law, a taxpayer may claim a deduction for charitable contributions, subject to certain limitations based on the type of taxpayer, the property contributed and the type of donee organization. In the case of non-cash contributions, the amount of the deduction generally equals the fair market value of the contributed property on the date of the contribution. The Administration is concerned that some taxpayers are claiming substantially inflated deductions for donations of patents and similar intellectual property to charities. To address these valuation issues, the Administration proposes to allow a taxpayer who contributes a patent or other intellectual property (other than certain copyrights) to charity to deduct up front the lesser of the taxpayer's basis in the donated property or the fair market value of the property. In future years, the taxpayer would be permitted to deduct additional amounts based on the amount of royalties or other revenue, if any, actually received by the donee charity from the donated property. No additional deduction would be permitted after ten years or after the expiration of a patent. The taxpayer would be required to obtain written substantiation from the donee of the amount of revenue derived from the donated property during the year. The proposed changes would be effective for taxable years beginning after December 31, 2003.

Prevent overvaluations and other abuses in charitable donations of used vehicles.—Under current law, a taxpayer may claim a deduction for charitable contributions of tangible personal property subject to certain limitations based on the type of taxpayer, the type of donee organization, and the use of the property by the donee organization. Except for inventory property, the amount of the deduction equals the fair market value of the contributed property if the use of the property by the donee is related to its exempt purpose or function. However, the amount of the deduction is limited to the lesser of the taxpayer's basis in the property (typically cost) or fair market value when the use of the property by the donee is unrelated to the donee's exempt purposes. As a practical matter, taxpayers are generally permitted to deduct the fair market value of donated vehicles, regardless of whether the vehicle is actually used for a charitable purpose or re-sold with the charity receiving some revenue from the sale. A taxpayer who donates a used car to charity and claims a deduction of less that $5,000 is permitted to use established used car pricing guides to determine fair market value, but only if the guide lists a sales price for a car of the same make, model, and year, sold in the same area, and in the same condition as the donated car. The Administration is concerned that the amount of the deduction claimed by taxpayers often exceeds the fair market value of the donated vehicles because taxpayers often use published values for cars in better condition than the donated vehicle. To curtail the problem of excessive donations being claimed for donated vehicles, the Administration proposes to allow a charitable deduction for contributions of vehicles only if the taxpayer obtains a qualified appraisal of the vehicle. The Department of Treasury would be permitted to establish an administrative safe harbor in published guidance. The proposal would not affect the rules governing charitable contributions of inventory property. The proposal would be effective for taxable years beginning after December 31, 2003.

Reform the tax treatment for leasing transactions with tax-indifferent parties.—Certain leasing transactions (often referred to as sale-in/lease-out or SILO transactions) involving tax-indifferent parties (including governments, charities, and foreign entities) do not provide financing related to the construction, purchase or refinancing of productive assets. Rather, they involve the payment of an accommodation fee by a U.S. taxpayer to the tax-indifferent party in exchange for the right of the U.S. taxpayer to claim tax benefits from the purported tax ownership of the property. These arrangements usually result in no change in the tax-indifferent party's use or operation of the property, and are designed to ensure that the U.S. taxpayer bears only limited economic risk. The U.S. taxpayer enjoys substantial current tax deductions, while postponing the recognition of taxable income well into the future. The Administration proposes to limit a taxpayer's annual deductions or losses related to a lease with a tax-indifferent party to the taxable income earned from the transaction for the taxable year. This limitation would apply to all deductions related to the lease. Any disallowed deductions would be carried forward and treated as deductions related to the lease in the next taxable year, subject to the same limitations. When a taxpayer completely disposes of its interest in the leased property, the taxpayer would be allowed to take previously disallowed deductions and losses. The proposal would exclude from these rules certain short-term leases with terms of three or fewer years, qualified asset leases, and other leases subsequently identified in published guidance. The proposal also clarifies that the depreciation recovery period for all depreciable or amortizable property leased to a tax-indifferent entity is the longer of the property's assigned class life or 125 percent of the lease term. For this purpose, the lease term would include service contracts and other arrangements that currently are used to shorten the stated lease term and thus, the asset's cost recovery period.

Ensure foreign subsidiaries of U.S. companies cannot inappropriately avoid U.S. tax on foreign earnings invested in U.S. property through use of the exception for bank deposits.—Under current law, U.S. shareholders of a controlled foreign corporation must include in income their pro rata share of its earnings that are invested in certain U.S. property. Deposits with persons carrying on the banking business are excluded from the definition of U.S. property subject to this rule. Concern has arisen that this exception is being interpreted so as to reach results that are not consistent with the underlying policy. Under the Administration's proposal, the exception for deposits with persons carrying on the banking business would be modified to eliminate this potential for abuse.

Modify tax rules for individuals who give up U.S. citizenship or green card status .—If an individual gives up U.S. citizenship, or terminates long-term U.S. residency, with a principal purpose of avoiding U.S. tax, the individual is subject to an alternative tax regime for 10 years following the individual's loss of citizenship or termination of residency. The Administration proposes to improve compliance with the tax rules applicable to individuals who expatriate by modifying the current-law alternative tax regime as follows: (1) The subjective "principal purpose" test of current law would be replaced with an objective test; (2) individuals who expatriate would continue to be taxed as U.S. citizens or residents until they give notice of the expatriating act or termination of residency; (3) special rules would be provided for individuals subject to the alternative tax regime who are physically present in the U.S. for more than 30 days in a calendar year during the 10-year period following expatriation; (4) certain gifts of stock of closely-held foreign corporations by a former citizen or former long-term resident would be subject to U.S. gift tax; and (5) annual reporting would be required for individuals subject to the alternative tax regime following expatriation.

Expand tax shelter exception for Federal practitioner privelege.—In general, a common law privilege of confidentiality exists for attorney-client communications with respect to legal advice. Communications relating to Federal tax advice between a taxpayer and a Federally authorized tax-practitioner (who may not be an attorney) are protected by a statutory confidentiality privilege to the same extent that the communication would be considered a privileged communication if it were between a taxpayer and an attorney. Written communications relating to corporate tax shelters are not covered by the statutory privilege. The exception to the privilege for communications relating to corporate tax shelters should be expanded to all tax shelters, regardless of whether or not the participant is a corporation. The Administration therefore proposes to modify the Federal tax practitioner privilege by expanding the tax shelter exception to cover written communication relating to any tax shelter.

Extend the statute of limitations for undisclosed reportable transactions.—In general, taxes cannot be assessed or collected unless an assessment is made within three years after a return is filed. If a taxpayer omits an item of gross income totaling more than 25 percent of the amount of gross income shown on the return, the statute of limitations is extended to six years. Extending the statute of limitations for transactions that are not disclosed properly on a return will encourage taxpayers to make the required disclosures and will provide the IRS with the time necessary to examine these transactions. The Administration proposes to extend the statue of limitations for taxpayers who fail to disclose reportable transactions until one year after the earlier of the date on which the taxpayer provides the required disclosures or the date on which the taxpayer's material advisor satisfies certain requirements relating to the maintenance of lists. The statute would be extended only with respect to any underpayment arising from the undisclosed transaction, and the proposal would not shorten any otherwise applicable statute of limitation.

Require increased reporting for noncash charitable contributions.—Under current law, any individual, closely-held corporation, or personal service corporation claiming a charitable contribution deduction for a contribution of property (other than publicly-traded securities) of more than $5,000 ($10,000 in the case of nonpublicly traded stock) must obtain a qualified appraisal for the property contributed. However, C corporations (other than personal service corporations and closely-held corporations) are not required to obtain a qualified appraisal. In order to reduce valuation abuses and assist the IRS in administering the tax laws, the Administration proposes to require all taxpayers to obtain a qualified appraisal for property (other than inventory property and publicly-traded securities) donated to charity if the deduction claimed exceeds $5,000. In addition, if the deduction claimed exceeds $500,000, the taxpayer would be required to provide a copy of the qualified appraisal or an executive summary of the qualified appraisal to the IRS. The proposal would be effective for taxable years beginning after December 31, 2003.

Clarify and simplify qualified tuition programs.—Current law provides special tax treatment for contributions to and distributions from qualified tuition programs under Section 529. The purpose of these programs is to encourage saving for the higher education expenses of designated beneficiaries. However, current law is unclear in certain situations with regard to the transfer tax consequences of changing the designated beneficiary of a qualified tuition program. In addition, current law may afford significant potential for transfer tax abuse through the use of these programs. The Administration's proposal would simplify the tax consequences under these programs, promote the educational purposes for which these programs were intended, and significantly reduce the opportunities for tax abuse.

Under the Administration's proposal, contributions to qualified tuition programs would be treated as completed gifts to the designated beneficiary. There would be no gift tax consequences to a distribution from, or a change in the designated beneficiary of, a qualified tuition program. As long as the funds are used for qualified higher education expenses, the income tax benefits under current law would be available, regardless of the identity of the designated beneficiary. The income portion of distributions not used for qualified higher education expenses would continue to be subject to income tax, as well as a 10 percent penalty, if applicable. The principal portion of any distribution from a qualified tuition program that is not used for higher education expenses would be subject to a new excise tax (payable from the account) once the cumulative amount of these distributions exceeds a stated amount per beneficiary. In addition, the excise tax would not apply to certain distributions made as a result of the beneficiary's death, disability, or receipt of a scholarship. New limitations would restrict designated beneficiaries to individuals under 35 years of age and would prohibit distributions to or for the benefit of any person other than the designated beneficiary of the program. The proposal also includes revised reporting requirements and special rules for trusts or other entities contributing to a qualified tuition program. The proposal would be effective for contributions made to qualified tuition programs after the date of enactment.

TAX ADMINISTRATION, UNEMPLOYMENT INSURANCE, AND OTHER

Improve Tax Administration

Modify the IRS Restructuring and Reform Act of 1998 (RRA98).—The proposed modification to RRA98 is comprised of six parts. The first part modifies employee infractions subject to mandatory termination and permits a broader range of available penalties. It strengthens taxpayer privacy while reducing employee anxiety resulting from unduly harsh discipline or unfounded allegations. The second part adopts measures to curb frivolous submissions and filings that are intended to impede or delay tax administration. The third part allows the IRS to terminate installment agreements when taxpayers fail to make timely tax deposits and file tax returns on current liabilities. The fourth part streamlines jurisdiction over collection due process cases in the Tax Court, thereby simplifying procedures and reducing the cycle time for certain collection due process cases. The fifth part permits taxpayers to enter into installment agreements that do not guarantee full payment of liability over the life of the agreement. It allows the IRS to enter into agreements with taxpayers who desire to resolve their tax obligations but cannot make payments large enough to satisfy their entire liability and for whom an offer in compromise is not a viable alternative. The sixth part eliminates the requirement that the IRS Chief Counsel provide an opinion for any accepted offer-in-compromise of unpaid tax (including interest and penalties) equal to or exceeding $50,000. This proposal requires that the Treasury Secretary establish standards to determine when an opinion is appropriate.

Initiate IRS cost saving measures.—The Administration has two proposals to improve IRS efficiency and performance from current resources. The first proposal modifies the way that Financial Management Services (FMS) recovers its transaction fees for processing IRS levies by permitting FMS to retain a portion of the amount collected before transmitting the balance to the IRS, thereby reducing government transaction costs. The offset amount would be included as part of the 15-percent limit on levies against income and would also be credited against the taxpayer's liability. The second proposal extends the April filing date for electronically filed tax returns to April 30th, provided that any tax due also is paid electronically. This proposal would encourage more taxpayers to file electronically and allow the IRS to process more returns and payments efficiently.

Repeal section 132 of the Revenue Act of 1978 and amend the tax code to authorize the Secretary of the Treasury to issue rules to address inappropriate nonqualified deferred compensation arrangements.—Section 132 currently prohibits the IRS from issuing new regulations on many aspects of nonqualified deferred compensation arrangements, restricting the ability of the IRS to respond effectively to these arrangements. Under the Administration's proposal, that prohibition would be removed and the Treasury Secretary would be given express authority to issue new rules. It is expected that new guidance would address when an individual's access to compensation is considered subject to substantial limitation, the extent to which company assets may be designated as available to meet deferred compensation obligations, and when an arrangement is treated as funded.

Increase continuous levy for certain Federal payments.—Under current law, the IRS is authorized to levy continuously up to 15 percent of specified Federal payments to collect outstanding tax obligations. Many Federal payments, such as salary, retirement, and benefit payments are regularly recurring payments that can be levied continuously until the outstanding tax obligation is satisfied. Other Federal payments, such as those to vendors for goods or services, are not regularly recurring and present fewer opportunities for collection. The Administration therefore proposes to allow the IRS to levy continuously up to 100 percent of Federal payments to vendors.

Permit private collection agencies to engage in specific, limited activities to support IRS collection efforts.—The resource and collection priorities of the IRS do not permit it to pursue continually all outstanding tax liabilities. Many taxpayers are aware of their outstanding tax liabilities, but have failed to pay them. The use of private collection agencies, or PCAs, to support IRS collection efforts would enable the Government to reach these taxpayers to obtain payment while allowing the IRS to focus its own enforcement resources on more complex cases and issues. PCAs would not have any enforcement power, and they would be strictly prohibited from threatening enforcement action or violating any taxpayer confidentiality protection or other taxpayer rights. The IRS would be required to monitor closely PCA activities and performance, including the protection of taxpayer rights. PCAs would be compensated out of the revenue collected through their activities, although compensation would be based on quality of service, taxpayer satisfaction, and case resolution, in addition to collection results.

Strengthen Financial Integrity of Unemployment Insurance

Strengthen the financial integrity of the unemployment insurance system by reducing tax avoidance and improper benefit payments.—Under current law, State unemployment insurance (UI) taxes are deposited into the Federal Unemployment Trust Fund and used by States to pay unemployment benefits. In order to receive full credit against Federal unemployment taxes, Federal law requires that employers' State tax rates be based in part on the unemployment experience of each employer. In general, the more unemployment benefits paid to former employees, the higher the tax rate of the employer. This feature of State tax law is commonly known as "experience rating." The Administration has a three-pronged proposal to strengthen the financial integrity of the UI system, including: Curtailing tax avoidance by certain unscrupulous employers who successfully manipulate their "experience rating;" reducing UI benefit overpayments; and improving collection of past overpayments. The proposal would require States to amend their UI tax laws to deter schemes to manipulate experience rates through such means as transfers of businesses to shell companies. In addition, the proposal would help reduce UI benefit overpayments by providing State UI agencies with access to information from the National Directory of New Hires for the quick detection of individuals who illegally collect unemployment benefits after returning to work. Finally, the proposal would help States collect more delinquent UI benefit overpayments through offsets of individuals' Federal income tax refunds. Many States already do this through their own State income tax system. These efforts to strengthen the financial integrity of the UI system will also help keep State UI taxes down and improve the solvency of State trust funds.

Other Proposals

Increase Indian gaming activity fees.—The National Indian Gaming Commission regulates and monitors gaming operations conducted on Indian lands. Since 1998, the Commission has been prohibited from collecting more than $8 million in annual fees from gaming operations to cover the costs of its oversight responsibilities. The Administration proposes to amend the current fee structure so that the Commission can adjust its activities to the growth in the Indian gaming industry.

REAUTHORIZE FUNDING FOR THE HIGHWAY TRUST FUND

Deposit full amount of excise tax imposed on gasohol in the Highway Trust Fund.—Under current law, an 18.4-cents-per-gallon excise tax is imposed on gasoline. In general, 18.3 cents per gallon of the gasoline excise tax is deposited in the Highway Trust Fund and 0.1 cent per gallon is deposited in the Leaking Underground Storage Tank (LUST) Trust Fund. In the case of gasohol, which is taxed at a reduced rate, 2.5 cents per gallon is retained in the General Fund of the Treasury, 0.1 cent per gallon is deposited in the LUST Trust Fund, and the balance of the reduced rate is deposited in the Highway Trust Fund. The Administration believes that it is appropriate that the entire amount of the excise tax on gasohol (except for the 0.1 cent per gallon deposited in the LUST Trust Fund) be deposited in the Highway Trust Fund. Effective for collections after September 30, 2003, the Administration proposes to transfer the 2.5 cents per gallon of the gasohol excise tax that is currently retained in the General Fund of the Treasury to the Highway Trust Fund.

Impose additional registration requirements on the transfer of tax-exempt fuel by pipeline, vessel, or barge.—Fuel tax evasion results in a substantial amount of lost revenue to the Highway Trust Fund. To prevent or reduce evasion of highway fuel taxes and to improve their collection, the Administration proposes the following changes, effective November 1, 2004: (1) To qualify for the fuel tax exemption provided to bulk transfers of taxable fuel to registered terminals or refineries, the fuel would have to be transferred by registered pipeline, vessel, or barge; (2) proof of registration would be required to be displayed on any vessel or barge used to transport taxable fuel; and (3) new penalties would be imposed for failure to comply with registration and display of proof of registration requirements. The penalty for failure to register would be $1,000 per day; the penalty for failure to display proof of registration would be $500 per day.

Repeal installment method for payment of heavy highway vehicle use tax.—The Administration proposes to repeal the current law provision that allows owners of heavy highway vehicles to pay the highway use tax in quarterly installments. Effective July 1, 2004, owners would be required to pay the annual tax in full with their returns. Installment payments have provided an opportunity for tax evasion by allowing owners to register vehicles for the entire tax year after payment of only the first installment of the annual tax.

Allow tax-exempt financing for private highway projects and rail-truck transfer facilities.—Interest on bonds issued by state and local governments to finance activities carried out and paid for by private persons (private activity bonds) is taxable unless the activities are specified in the Internal Revenue Code. The volume of certain tax-exempt private activity bonds that state and local governments may issue in each calendar year is limited by state-wide volume limits. The Administration proposes to provide authority to issue an aggregate of $15 billion of tax-exempt private activity bonds beginning in 2004 for the development of highway facilities and surface freight transfer facilities. Highway facilities eligible for financing would consist of any surface transportation project eligible for Federal assistance under Title 13 of the United States Code, or any project for an international bridge or tunnel for which an international entity authorized under Federal or State law is responsible. Surface freight transfer facilities would consist of facilities for the transfer of freight from truck to rail or rail to truck, including any temporary storage facilities directly related to those transfers. The Secretary of Transportation would allocate the $15 billion, which would not be subject to the aggregate annual state private activity bond volume limit, among competing projects.

EXTEND EXPIRING PROVISIONS

Extend minimum tax relief for individuals.—A temporary provision of current law permits nonrefundable personal tax credits to offset both the regular tax and the alternative minimum tax for taxable years beginning before January 1, 2004. The Administration is concerned that the AMT may limit the benefit of personal tax credits and impose financial and compliance burdens on taxpayers who have few, if any, tax preference items and who were not the originally intended subjects of the AMT. The Administration proposes to extend minimum tax relief for nonrefundable personal credits for two years, to apply to taxable years 2004 and 2005. The proposed extension does not apply to the child credit, the new saver credit, the earned income credit or the adoption credit, which were provided AMT relief through December 31, 2010 under the 2001 tax cut. The refundable portion of the child credit and the earned income tax credit are also allowed against the AMT through December 31, 2010.

A temporary provision of current law increased the AMT exemption amounts to $40,250 for single taxpayers, $58,000 for married taxpayers filing a joint return and surviving spouses, and $29,000 for married taxpayers filing a separate return and estates and trusts. Effective for taxable years beginning after December 31, 2004, the AMT exemption amounts will decline to $33,750 for single taxpayers, $45,000 for married taxpayers filing a joint return and surviving spouses, and $22,500 for married taxpayers filing a separate return and estates and trusts. The Administration proposes to extend the temporary, higher exemption amounts through taxable year 2005.

The design of the AMT causes it increasingly to extend to middle-income taxpayers. The AMT's original focus, however, was on high-income taxpayers who have arranged their affairs to eliminate most or all Federal income taxes. Although temporary changes have and will continue to address this issue for the near term, long-term change is needed. The Treasury Department has been directed to study the AMT with the goal of producing a long-term solution.

Extend permanently the research and experimentation (R&E) tax credit.—The Administration proposes to extend permanently the 20-percent tax credit for qualified research and experimentation expenditures above a base amount and the alternative incremental credit, which are scheduled to expire on June 30, 2004.

In addition, the Administration is concerned that features of the R&E credit may limit its effectiveness in encouraging taxpayers to invest in R&E. Consequently, the Treasury Department has been directed to study how the credit can be restructured to make it more effective. The Administration will work closely with the Congress to develop and enact reforms to rationalize the R&E credit and to improve its incentive effect.

Repeal the disallowance of certain deductions of mutual life insurance companies.—Life insurance companies may generally deduct policyholder dividends, while dividends to stockholders are not deductible. Section 809 of the Internal Revenue Code attempts to identify amounts returned by mutual life insurance companies to holders of participating policies in their role as owners of the company, and generally disallows a deduction for mutual company policyholder dividends (or otherwise increases taxable income by reducing the amount of end-of-year reserves) in an amount equal to the amount identified under section 809. Section 809 has been criticized as being theoretically unsound, overly complex, inaccurate in its measurement of income, unfair, and increasingly irrelevant. The 2002 economic stimulus bill suspended the operation of section 809 for three years, 2001 through 2003. The Administration proposes to repeal section 809.

Extend and modify the work opportunity tax credit and the welfare-to-work tax credit.—Under present law, the work opportunity tax credit provides incentives for hiring individuals from certain targeted groups. The credit generally applies to the first $6,000 of wages paid to several categories of economically disadvantaged or handicapped workers. The credit rate is 25 percent of qualified wages for employment of at least 120 hours but less than 400 hours and 40 percent for employment of 400 or more hours. The credit is available for a qualified individual who begins work before January 1, 2004.

Under present law, the welfare-to-work tax credit provides an incentive for hiring certain recipients of long-term family assistance. The credit is 35 percent of up to $10,000 of eligible wages in the first year of employment and 50 percent of wages up to $10,000 in the second year of employment. Eligible wages include cash wages plus the cash value of certain employer-paid health, dependent care, and educational fringe benefits. The minimum employment period that employees must work before employers can claim the credit is 400 hours. This credit is available for qualified individuals who begin work before January 1, 2004.

The Administration proposes to simplify employment incentives by combining the credits into one credit and making the rules for computing the combined credit simpler. The credits would be combined by creating a new welfare-to-work targeted group under the work opportunity tax credit. The minimum employment periods and credit rates for the first year of employment under the present work opportunity tax credit would apply to welfare-to-work employees. The maximum amount of eligible wages would continue to be $10,000 for welfare-to-work employees and $6,000 for other targeted groups. In addition, the second year 50-percent credit currently available under the welfare-to-work credit would continue to be available for welfare-to-work employees under the modified work opportunity tax credit. Qualified wages would be limited to cash wages. The work opportunity tax credit would also be simplified by eliminating the need to determine family income for qualifying ex-felons (one of the present targeted groups). The modified work opportunity tax credit would apply retroactively (provided specified filing deadlines are met) to individuals who begin work after December 31, 2003 and before January 1, 2006.

Extend the District of Columbia (DC) Enterprise Zone.—The DC Enterprise Zone includes the DC Enterprise Community and District of Columbia census tracts with a poverty rate of at least 20 percent. Businesses in the zone are eligible for: (1) A wage credit equal to 20 percent of the first $15,000 in annual wages paid to qualified employees who reside within the District of Columbia; (2) $35,000 in increased section 179 expensing; and (3) in certain circumstances, tax-exempt bond financing. In addition, a capital gains exclusion is allowed for certain investments held more than five years and made within the DC Zone, or within any District of Columbia census tract with a poverty rate of at least 10 percent. The DC Zone incentives apply for the period from January 1, 1998 through December 31, 2003. The Administration proposes to extend the DC Zone incentives for two years, making the incentives applicable through December 31, 2005.

Extend the first-time homebuyer credit for the District of Columbia.—A one-time, nonrefundable $5,000 credit is available to purchasers of a principal residence in the District of Columbia who have not owned a residence in the District during the year preceding the purchase. The credit phases out for taxpayers with modified adjusted gross income between $70,000 and $90,000 ($110,000 and $130,000 for joint returns). The credit does not apply to purchases after December 31, 2003. The Administration proposes to extend the credit for two years, making the credit available with respect to purchases after December 31, 2003 and before January 1, 2006.

Extend authority to issue Qualified Zone Academy Bonds.—Current law allows State and local governments to issue "qualified zone academy bonds,"' the interest on which is effectively paid by the Federal government in the form of an annual income tax credit. The proceeds of the bonds have to be used for teacher training, purchases of equipment, curriculum development, or rehabilitation and repairs at certain public school facilities. A nationwide total of $400 million of qualified zone academy bonds were authorized to be issued in each of calendar years 1998 through 2003. In addition, unused authority arising in 1998 and 1999 can be carried forward for up to three years and unused authority arising in 2000 through 2003 can be carried forward for up to two years. The Administration proposes to authorize the issuance of an additional $400 million of qualified zone academy bonds in each of calendar years 2004 and 2005; unused authority could be carried forward for up to two years. Reporting of issuance would be required.

Extend deduction for corporate donations of computer technology.—The charitable contribution deduction that may be claimed by corporations for donations of inventory property generally is limited to the lesser of fair market value or the corporation's basis in the property. However, corporations are provided augmented deductions, not subject to this limitation, for certain contributions. Under current law, an augmented deduction is provided for contributions of computer technology and equipment to public libraries and to U.S. schools for educational purposes in grades K-12. The Administration proposes to extend the deduction, which expires with respect to donations made after December 31, 2003, to apply to donations made before January 1, 2006.

Allow net operating losses to offset 100 percent of alternative minimum taxable income.—Under current law (and under law in effect prior to 2001) net operating loss (NOL) deductions cannot reduce a taxpayer's alternative minimum taxable income (AMTI) by more than 90 percent. Under the 2002 economic stimulus bill, this limitation was temporarily waived. The Administration's proposal would extend this waiver through 2005. NOL carrybacks arising in taxable years ending in 2003, 2004, and 2005, or carryforwards to these years, would offset up to 100 percent of a taxpayer's AMTI.

Extent permanently IRS user fees.—The Administration proposes to extend permanently IRS authority to charge fees for written responses to questions from individuals, corporations, and organizations related to their tax status or the effects of particular transactions for tax purposes. Under current law, these fees are scheduled to expire effective with requests made after December 31, 2004.

Extend provisions permitting disclosure of tax return information relating to terrorist activity.—Current law permits disclosure of tax return information relating to terrorism in two situations. The first is when an executive of a Federal law enforcement or intelligence agency has reason to believe that the return information is relevant to a terrorist incident, threat or activity and submits a written request. The second is when the IRS wishes to apprise a Federal law enforcement agency of a terrorist incident, threat or activity. The Administration proposes to extend this disclosure authority, which expired on December 31, 2003, through December 31, 2004.

Extend abandoned mine reclamation fees.—Collections from abandoned mine reclamation fees are allocated to States and Tribes for reclamation grants. Current fees of 35 cents per ton for surface mined coal, 15 cents per ton for underground mined coal, and 10 cents per ton for lignite coal are scheduled to expire on September 30, 2004. Abandoned land problems are expected to exist in certain States after all the money from the collection of fees under current law is expended. The Administration proposes to extend these fees at a reduced rate. The Administration also proposes to modify the authorization language to allocate more of the receipts collected toward restoration of abandoned coal mine land.

Extend authority to issue Liberty Zone Bonds.—The 2002 economic stimulus bill provided authority to issue an aggregate of $8 billion of tax-exempt private activity bonds during calendar years 2002, 2003, and 2004 for the acquisition, construction, reconstruction, and renovation of nonresidential real property, residential rental property, and public utility property in the New York City Liberty Zone. Authority to issue these bonds, which are not subject to the aggregate annual State private activity bond volume limit, is proposed to be extended through calendar year 2009.

Extend excise tax on coal at current rates.—Excise taxes levied on coal mined and sold for use in the United States are deposited in the Black Lung Disability Trust Fund. Amounts deposited in the Fund are used to cover the cost of program administration and compensation, medical, and survivor benefits to eligible miners and their survivors, when mine employment terminated prior to 1970 or when no mine operator can be assigned liability. Current tax rates on coal sold by a producer are $1.10 per ton of coal from underground mines and $.55 per ton of coal from surface mines; however, these rates may not exceed 4.4 percent of the price at which the coal is sold. Effective for coal sold after December 31, 2013, the tax rates on coal from underground mines and surface mines will decline to $.50 per ton and $.25 per ton, respectively, and will be capped at 2 percent of the price at which the coal is sold. The Administration proposes to repeal the reduction in these tax rates effective for sales after December 31, 2013, and keep current rates in effect until the Black Lung Disability Trust Fund debt is repaid.

PROMOTE TRADE

Implement free trade agreements with Morocco, Australia, and Central American countries.—Free trade agreements are expected to be completed with Morocco, Australia, and Central American countries in 2004, with ten-year implementation to begin in fiscal year 2005. These agreements will benefit U.S. producers and consumers, as well as strengthen the economies of Morocco, Australia, and Central America.

RESPOND TO FOREIGN SALES CORPORATION/EXTRATERRITORIAL INCOME DECISIONS

World Trade Organization (WTO) panels have ruled that the extraterritorial income (ETI) exclusion provisions and the foreign sales corporation (FSC) provisions of the Internal Revenue Code constitute prohibited export subsidies under the WTO rules. To comply with the WTO ruling and honor the United States' WTO obligations, the current-law ETI provisions must be repealed. At the same time, meaningful changes to our tax law are required to preserve the competitiveness of U.S. businesses operating in the global marketplace. Thus, the Administration believes the necessary repeal of the ETI provisions must be coupled with other tax law changes that promote the competitiveness of American manufacturers and other job-creating sectors of the U.S. economy. Tax law changes that would provide a benefit to these contributors to the U.S. economy include corporate tax rate reduction, alternative minimum tax reform, extension of net operating loss carryback rules, expansion and permanence of the research credit, improvements in depreciation rules, business tax simplification, and rationalization of the international tax rules. The Administration intends to work closely with the Congress on prompt enactment of legislation that brings our tax law into compliance with WTO rules and makes changes to the tax law to enhance the competitiveness of American businesses and the workers they employ. The Administration believes this legislation should achieve these objectives on as close to a budget neutral basis as possible.

Table 16–3. EFFECT OF PROPOSALS ON RECEIPTS

(in millions of dollars)

	2004	2005	2006	2007	2008	2009	2005–09	2005–14
Make Permanent The Tax Cuts Enacted in 2001 and 2003 (assumed in the baseline):								
Extend through 2010 certain provisions of the 2003 jobs and growth tax cut:								
Child tax credit[1]	....	–2,166	–8,930	–9,023	–9,067	–8,325	–37,511	–42,079
Marriage penalty relief	....	–5,318	–6,634	–3,883	–1,850	–423	–18,108	–18,108
10–percent individual income tax rate bracket	....	–4,005	–5,981	–6,435	–4,036	–2,956	–23,413	–27,343
Total extend through 2010 certain provisions of the 2003 jobs and growth tax cut	....	–11,489	–21,545	–19,341	–14,953	–11,704	–79,032	–87,530
Extend permanently certain provisions of the 2001 tax cut and the 2003 jobs and growth tax cut:								
Dividends tax rate structure	....	498	486	485	642	–17,272	–15,161	–81,280
Capital gains tax rate structure	....	....	....	....	–5,268	–7,366	–12,634	–49,970
Expensing for small business	....	226	–3,336	–5,711	–4,102	–3,205	–16,128	–24,798
Marginal individual income tax rate reductions	....	....	....	....	....	....	....	–395,269
Child tax credit[2]	....	....	....	....	....	....	....	–72,786
Marriage penalty relief[3]	....	....	....	....	....	....	....	–32,426
Education incentives	....	–11	–16	–22	–24	–37	–110	–6,758
Repeal of estate and generation-skipping transfer taxes, and modification of gift taxes	....	–1,000	–1,609	–1,732	–1,977	–2,244	–8,562	–180,111
Modifications of pension plans	....	....	....	....	....	....	....	–1,804
Other incentives for families and children	....	....	....	....	....	....	....	–3,531
Total extend permanently certain provisions of the 2001 tax cut and the 2003 jobs and growth tax cut	....	–287	–4,475	–6,980	–10,729	–30,124	–52,595	–848,733
Total make permanent the tax cuts enacted in 2001 and 2003	....	–11,776	–26,020	–26,321	–25,682	–41,828	–131,627	–936,263
Tax Incentives:								
Simplify and encourage saving:								
Expand tax-free savings opportunities	....	3,949	8,192	5,488	2,798	685	21,112	5,558
Consolidate employer-based savings accounts	....	–214	–318	–337	–358	–380	–1,607	–11,763
Establish Individual Development Accounts (IDAs)	....	–134	–286	–326	–300	–255	–1,301	–1,380

Table 16–3. EFFECT OF PROPOSALS ON RECEIPTS—Continued

(in millions of dollars)

	2004	2005	2006	2007	2008	2009	2005–09	2005–14
Total simplify and encourage saving	....	3,601	7,588	4,825	2,140	50	18,204	–7,585
Invest in health care:								
Provide refundable tax credit for the purchase of health insurance [4]	....	–24	–1,417	–1,059	–854	–632	–3,986	–4,700
Provide an above-the-line deduction for high-deductible insurance premiums	....	–173	–1,764	–2,014	–2,292	–2,501	–8,744	–24,775
Provide an above-the-line deduction for long-term care insurance premiums	....	–68	–489	–805	–1,572	–2,435	–5,369	–21,428
Provide an additional personal exemption to home caregivers of family members	....	–71	–460	–398	–398	–415	–1,742	–3,759
Allow the orphan drug tax credit for certain pre-designation expenses	....	....	....	....	....	....	–1	–2
Clarify the Health Coverage Tax Credit [5]	....	....	....	....	....	....	....	....
Total invest in health care	....	–336	–4,130	–4,276	–5,116	–5,983	–19,841	–54,662
Provide incentives for charitable giving:								
Provide charitable contribution deduction for nonitemizers	....	–1,248	–1,103	–1,111	–1,144	–1,173	–5,779	–12,036
Permit tax-free withdrawals from IRAs for charitable contributions	–68	–450	–341	–327	–330	–329	–1,777	–3,498
Expand and increase the enhanced charitable deduction for contributions of food inventory	....	–42	–87	–96	–106	–116	–447	–1,224
Reform excise tax based on investment income of private foundations	....	–133	–83	–84	–86	–90	–476	–1,009
Modify tax on unrelated business taxable income of charitable remainder trusts	....	–8	–5	–6	–6	–6	–31	–68
Modify basis adjustment to stock of S corporations contributing appreciated property	....	–21	–13	–15	–18	–21	–88	–239
Repeal the $150 million limitation on qualified 501(c)(3) bonds	....	–8	–10	–11	–10	–10	–49	–94
Repeal certain restrictions on the use of qualified 501(c)(3) bonds for residential rental property	....	–5	–6	–12	–18	–25	–66	–299
Total provide incentives for charitable giving	–68	–1,915	–1,648	–1,662	–1,718	–1,770	–8,713	–18,467
Strengthen education:								
Extend, increase, and expand the above-the-line deduction for qualified out-of-pocket classroom expenses	–23	–229	–240	–249	–260	–263	–1,241	–2,611
Encourage telecommuting:								
Exclude from income the value of employer-provided computers, software, and peripherals	....	–27	–45	–43	–48	–55	–218	–668
Increase housing opportunities:								
Provide tax credit for developers of affordable single-family housing	....	–7	–81	–327	–776	–1,352	–2,543	–16,409
Protect the environment:								
Extend permanently expensing of brownfields remediation costs	–178	–243	–212	–201	–191	–181	–1,028	–1,858
Exclude 50 percent of gains from the sale of property for conservation purposes	....	–45	–88	–101	–58	....	–292	–292
Total protect the environment	–178	–288	–300	–302	–249	–181	–1,320	–2,150
Increase energy production and promote energy conservation:								
Extend and modify the tax credit for producing electricity from certain sources	....	–401	–337	–305	–278	–139	–1,460	–2,175
Provide tax credit for residential solar energy systems	....	–12	–11	–17	–23	–10	–73	–73
Modify treatment of nuclear decommissioning funds	....	–193	–147	–154	–162	–169	–825	–1,767
Provide tax credit for purchase of certain hybrid and fuel cell vehicles	....	–79	–223	–376	–556	–542	–1,776	–2,211
Provide tax credit for energy produced from landfill gas	....	–34	–67	–91	–104	–117	–413	–737
Provide tax credit for combined heat and power property	....	–154	–107	–64	–62	–13	–400	–349
Extend excise tax exemption (credit) for ethanol [5]	....	....	....	....	....	....	....	....
Permit electric utilities to defer gain from sales of electric transmission property	–11	–475	–615	–532	–227	100	–1,749	361
Modify tax treatment of certain income of electric cooperatives	....	–14	–20	–21	–22	–23	–100	–235
Total increase energy production and promote energy conservation	–11	–1,362	–1,527	–1,560	–1,434	–913	–6,796	–7,186
Total tax incentives	–280	–563	–383	–3,594	–7,461	–10,467	–22,468	–109,738

Table 16–3. EFFECT OF PROPOSALS ON RECEIPTS—Continued

(in millions of dollars)

	2004	2005	2006	2007	2008	2009	2005–09	2005–14
Simplify the Tax Laws for Families:								
Establish uniform definition of a qualifying child[6]	....	–38	–34	–29	–20	–9	–130	–142
Simplify adoption tax benefits	....	–4	–39	–40	–42	–43	–168	–411
Eliminate household maintenance test for head-of-household filing status	....	–123	–297	–284	–285	–281	–1,270	–2,555
Reduce computational complexity of refundable child tax credit[7]	....	....	....	....	....	....	....	21
Simplify EITC eligibility requirements regarding filing status, presence of children, investment income, and work and immigration status[8]	....	64	–36	–35	–32	–33	–72	–272
Simplify the taxation of dependents	....	–11	–25	–20	–25	–43	–124	–498
Consolidate rules for lifetime learning credit, Hope credit, and education expense deductions, and simplify other higher education provisions	....	–19	–94	–311	–294	–282	–1,000	–2,558
Allow annual reporting and payment of combined State and Federal unemployment insurance taxes by employers of household employees	....	–20	–1	–1	–1	–1	–24	–30
Simplify taxation of capital gains on collectibles, small business stock, and other assets	....	–4	5	11	–1	–17	–6	–35
Total simplify the tax laws for families	....	–155	–521	–709	–700	–709	–2,794	–6,480
Strengthen the Employer-Based Pension System:								
Ensure fair treatment of older workers in cash balance conversions and protect defined benefit plans	....	....	....	....	....	....	....	2,373
Improve the accuracy of pension liability measures	8,537	12,297	7,340	3,042	–1,586	–5,467	15,626	–15,869
Total strengthen the employer-based pension system	8,537	12,297	7,340	3,042	–1,586	–5,467	15,626	–13,496
Close Loopholes and Improve Tax Compliance:								
Combat abusive tax avoidance transactions	....	46	63	85	113	128	435	1,071
Limit related party interest deductions	....	–51	93	146	203	265	656	3,116
Modify qualification rules for tax-exempt property-casualty insurance companies	....	67	114	116	119	121	537	1,184
Prevent abusive overvaluations on donations of patents and other intellectual property	....	432	270	273	277	287	1,539	3,207
Prevent overvaluations and other abuses in charitable donations of used vehicles	....	158	102	105	108	112	585	1,197
Reform the treatment for leasing transactions with tax-indifferent parties	340	1,591	2,712	3,285	3,565	3,766	14,919	33,385
Ensure foreign subsidiaries of U.S. companies cannot inappropriately avoid U.S. tax on foreign earnings invested in U.S. property through use of the exception for bank deposits	....	24	21	22	22	23	112	234
Modify tax rules for individuals who give up U.S. citizenship or green card status	1	23	20	22	24	25	114	272
Require increased reporting for noncash charitable contributions	....	49	31	32	33	34	179	367
Clarify and simplify qualified tuition programs	....	7	12	13	13	17	62	194
Total close loopholes and improve tax compliance	341	2,346	3,438	4,099	4,477	4,778	19,138	44,227
Tax Administration, Unemployment Insurance, and Other:								
Improve tax administration:								
Implement IRS administrative reforms	....	52	47	46	47	49	241	505
Increase continuous levy for certain Federal payments	....	10	18	19	20	20	87	202
Permit private collection agencies to engage in specific, limited activities to support IRS collection efforts	....	....	47	151	190	153	541	1,531
Total improve tax administration	....	62	112	216	257	222	869	2,238
Strengthen financial integrity of unemployment insurance:								
Strengthen the financial integrity of the unemployment insurance system by reducing tax avoidance and improper benefit payments[9]	....	....	–2	108	142	120	368	–216
Other proposals:								
Increase Indian gaming activity fees	....	....	4	4	5	5	18	43
Total tax administration, unemployment insurance, and other	....	62	114	328	404	347	1,255	2,065

Table 16–3. EFFECT OF PROPOSALS ON RECEIPTS—Continued

(in millions of dollars)

	2004	2005	2006	2007	2008	2009	2005–09	2005–14
Reauthorize Funding for the Highway Trust Fund:								
Deposit full amount of excise tax imposed on gasohol in the Highway Trust Fund [9]	....	....	648	666	681	699	2,694	6,443
Impose additional registration requirements on the transfer of tax-exempt fuel by pipeline, vessel, or barge [9]	....	76	93	96	91	87	443	747
Repeal installment method for payment of heavy highway vehicle use tax [9]	407	30	31	32	31	32	156	341
Allow tax-exempt financing for private highway projects and rail-truck transfer facilities	....	–20	–49	–77	–94	–97	–337	–619
Total reauthorize funding for the Highway Trust Fund	407	86	723	717	709	721	2,956	6,912
Expiring Provisions:								
Minimum tax relief for individuals	–86	–9,383	–13,881	....	....	....	–23,264	–23,264
Research & Experimentation (R&E) tax credit	–672	–3,610	–5,187	–6,291	–7,129	–7,775	–29,992	–78,351
Repeal the disallowance of certain deductions of mutual life insurance companies	....	–85	–51	–48	–45	–43	–272	–471
Combined work opportunity/welfare-to-work tax credit	–12	–187	–268	–162	–86	–46	–749	–768
DC tax incentives	–47	–97	–54	–7	–9	–24	–191	–363
Authority to issue Qualified Zone Academy Bonds	–2	–9	–15	–22	–28	–30	–104	–254
Deduction for corporate donations of computer technology	....	–180	–46	....	....	....	–226	–226
Net operating loss offset of 100 percent of alternative minimum taxable income	–1,326	–755	–101	203	154	129	–370	82
IRS user fees	....	32	44	45	46	47	214	464
Disclosure of tax return information related to terrorist activity [5]	....	....	....	....	....	....	....	....
Abandoned mine reclamation fees	....	239	245	252	256	262	1,254	2,550
Authority to issue Liberty Zone Bonds	....	–8	–27	–45	–62	–79	–221	–616
Excise tax on coal [9]	....	....	....	....	....	....	....	180
Total extend other expiring provisions	–2,145	–14,043	–19,341	–6,075	–6,903	–7,559	–53,921	–101,037
Promote Trade:								
Implement free trade agreements with Morocco, Australia, and Central American countries [9]	....	–389	–583	–675	–749	–831	–3,227	–8,305
Total budget proposals [10]	6,860	–12,135	–35,233	–29,188	–37,491	–61,015	–175,062	–1,122,115

* $500,000 or less.

[1] Affects both receipts and outlays. Only the receipt effect is shown here. The outlay effect is $4,265 million for 2006, $4,131 million for 2007, $4,003 million for 2008, $3,936 million for 2009, $16,335 million for 2005–2009 and $18,906 million for 2005–2014.

[2] Affects both receipts and outlays. Only the receipt effect is shown here. The outlay effect is $28,903 million for 2005–2014.

[3] Affects both receipts and outlays. Only the receipt effect is shown here. The outlay effect is $5,676 million for 2005–2014.

[4] Affects both receipts and outlays. Only the receipt effect is shown here. The outlay effect is $82 million for 2005, $3,760 million for 2006, $5,041 million for 2007, $6,388 million for 2008, $7,133 million for 2009, $22,404 million for 2005–2009 and $65,355 million for 2005–2014.

[5] Policy proposal with a receipt effect of zero.

[6] Affects both receipts and outlays. Only the receipt effect is shown here. The outlay effect is $36 million for 2006, $36 million for 2007, $36 million for 2008, $37 million for 2009, $145 million for 2005–2009 and $333 million for 2005–2014.

[7] Affects both receipts and outlays. Only the receipt effect is shown here. The outlay effect is –$181 million for 2006, –$183 million for 2007, –$185 million for 2008, –$187 million for 2009, –$736 million for 2005–2009 and –$1,701 million for 2005–2014.

[8] Affects both receipts and outlays. Only the receipt effect is shown here. The outlay effect is –$440 million for 2005, $131 million for 2006, $130 million for 2007, $119 million for 2008, $134 million for 2009, $74 million for 2005–2009 and $643 million for 2005–2014.

[9] Net of income offsets.

[10] Includes proposals assumed in the baseline.

Table 16–4. RECEIPTS BY SOURCE

(In millions of dollars)

Source	2003 Actual	Estimate					
		2004	2005	2006	2007	2008	2009
Individual income taxes (federal funds):							
Existing law	793,699	765,770	892,318	992,132	1,073,730	1,161,925	1,259,118
Proposed Legislation	....	–371	–18,481	–35,680	–24,444	–28,575	–49,244
Total individual income taxes	**793,699**	**765,399**	**873,837**	**956,452**	**1,049,286**	**1,133,350**	**1,209,874**
Corporation income taxes:							
Federal funds:							
Existing law	131,877	162,051	221,930	248,159	254,285	259,375	265,722
Proposed Legislation	....	6,690	8,266	1,854	–3,243	–7,262	–10,041
Total Federal funds corporation income taxes	131,877	168,741	230,196	250,013	251,042	252,113	255,681
Trust funds:							
Hazardous substance superfund	–99	....	....	....	....	....	....
Total corporation income taxes	**131,778**	**168,741**	**230,196**	**250,013**	**251,042**	**252,113**	**255,681**
Social insurance and retirement receipts (trust funds):							
Employment and general retirement:							
Old-age and survivors insurance (Off-budget)	447,806	456,513	491,627	515,586	543,900	570,695	597,465
Disability insurance (Off-budget)	76,036	77,491	83,474	87,551	92,361	96,910	101,457
Hospital insurance	147,186	150,540	165,173	173,748	183,790	193,294	202,831
Railroad retirement:							
Social Security equivalent account	1,620	1,658	1,680	1,705	1,738	1,771	1,794
Rail pension and supplemental annuity	2,333	2,227	2,116	2,127	2,165	2,202	2,240
Total employment and general retirement	674,981	688,429	744,070	780,717	823,954	864,872	905,787
On-budget	151,139	154,425	168,969	177,580	187,693	197,267	206,865
Off-budget	523,842	534,004	575,101	603,137	636,261	667,605	698,922
Unemployment insurance:							
Deposits by States [1]	26,702	32,418	38,146	40,970	41,912	42,557	43,197
Proposed Legislation	....	....	–21	–33	103	143	114
Federal unemployment receipts [1]	6,520	6,679	6,988	7,581	7,972	6,523	6,473
Proposed Legislation	....	....	1	30	31	33	34
Railroad unemployment receipts [1]	144	130	103	109	125	126	111
Total unemployment insurance	33,366	39,227	45,217	48,657	50,143	49,382	49,929
Other retirement:							
Federal employees' retirement—employee share	4,578	4,690	4,619	4,591	4,553	4,509	4,406
Non-Federal employees retirement [2]	53	46	42	39	36	33	30
Total other retirement	4,631	4,736	4,661	4,630	4,589	4,542	4,436
Total social insurance and retirement receipts	**712,978**	**732,392**	**793,948**	**834,004**	**878,686**	**918,796**	**960,152**
On-budget	189,136	198,388	218,847	230,867	242,425	251,191	261,230
Off-budget	523,842	534,004	575,101	603,137	636,261	667,605	698,922
Excise taxes:							
Federal funds:							
Alcohol taxes	7,893	8,051	8,170	8,270	8,358	8,471	8,597
Proposed Legislation	....	–58	–79	–21	....	....	....
Tobacco taxes	7,934	7,990	7,907	7,850	7,793	7,719	7,635
Transportation fuels tax	920	1,004	1,058	310	318	325	331
Proposed Legislation	....	–701	–750	....	....	....	....
Telephone and teletype services	5,788	6,319	6,798	7,183	7,596	8,040	8,509
Other Federal fund excise taxes	1,269	1,484	1,528	1,563	1,599	1,635	1,689
Proposed Legislation	....	58	–54	–62	–84	–86	–90
Total Federal fund excise taxes	23,804	24,147	24,578	25,093	25,580	26,104	26,671
Trust funds:							
Highway	33,726	34,270	35,680	36,920	37,869	38,763	39,669

Table 16–4. RECEIPTS BY SOURCE—Continued

(In millions of dollars)

Source	2003 Actual	Estimate					
		2004	2005	2006	2007	2008	2009
Proposed Legislation	....	1,242	887	1,015	1,031	1,039	1,040
Airport and airway	8,684	9,751	10,677	11,332	11,944	12,595	13,304
Aquatic resources	392	415	428	440	454	469	482
Black lung disability insurance	506	542	540	552	572	594	611
Inland waterway	90	94	95	96	96	97	98
Vaccine injury compensation	138	127	128	130	130	132	133
Leaking underground storage tank	184	188	197	202	208	211	217
Proposed Legislation	....	....	....	1	1	....	....
Total trust funds excise taxes	43,720	46,629	48,632	50,688	52,305	53,900	55,554
Total excise taxes	**67,524**	**70,776**	**73,210**	**75,781**	**77,885**	**80,004**	**82,225**
Estate and gift taxes:							
Federal funds	21,959	23,909	23,097	25,710	23,474	24,261	25,640
Proposed Legislation	....	....	–1,655	–1,853	–1,984	–2,090	–2,034
Total estate and gift taxes	**21,959**	**23,909**	**21,442**	**23,857**	**21,490**	**22,171**	**23,606**
Customs duties:							
Federal funds	19,039	20,831	21,320	23,774	25,614	27,150	29,596
Proposed Legislation	....	885	–179	–426	–538	–627	–724
Trust funds	823	879	954	1,035	1,107	1,123	1,148
Total customs duties	**19,862**	**22,595**	**22,095**	**24,383**	**26,183**	**27,646**	**30,020**
MISCELLANEOUS RECEIPTS: [3]							
Miscellaneous taxes	93	98	101	100	101	103	105
Proposed Legislation	....	....	....	4	4	5	5
United Mine Workers of America combined benefit fund	190	153	143	136	128	124	123
Deposit of earnings, Federal Reserve System	21,878	22,880	25,262	29,779	34,646	39,672	43,080
Defense cooperation	9	7	7	7	8	8	8
Confiscated Assets	1,917	....	....	....	....	....	....
Fees for permits and regulatory and judicial services	7,707	8,724	8,374	8,449	8,639	8,612	8,796
Proposed Legislation	....	....	271	289	297	302	309
Fines, penalties, and forfeitures	2,850	3,398	2,850	2,875	2,898	2,920	2,942
Proposed Legislation	....	–885	–341	–351	–362	–373	–384
Gifts and contributions	211	204	184	196	180	186	187
Refunds and recoveries	–313	–298	–306	–308	–316	–324	–332
Total miscellaneous receipts	**34,542**	**34,281**	**36,545**	**41,176**	**46,223**	**51,235**	**54,839**
Adjustment for revenue uncertainty [4]	....	**–20,000**	**–15,000**	....	....	....	....
Total budget receipts	**1,782,342**	**1,798,093**	**2,036,273**	**2,205,666**	**2,350,795**	**2,485,315**	**2,616,397**
On-budget	1,258,500	1,264,089	1,461,172	1,602,529	1,714,534	1,817,710	1,917,475
Off-budget	523,842	534,004	575,101	603,137	636,261	667,605	698,922
MEMORANDUM							
Federal funds	1,025,170	1,018,566	1,195,990	1,319,965	1,420,122	1,513,425	1,601,537
Trust funds	467,557	501,441	550,348	615,937	650,879	681,480	714,622
Interfund transactions	–234,227	–255,918	–285,166	–333,373	–356,467	–377,195	–398,684
Total on-budget	**1,258,500**	**1,264,089**	**1,461,172**	**1,602,529**	**1,714,534**	**1,817,710**	**1,917,475**
Off-budget (trust funds)	**523,842**	**534,004**	**575,101**	**603,137**	**636,261**	**667,605**	**698,922**
Total	**1,782,342**	**1,798,093**	**2,036,273**	**2,205,666**	**2,350,795**	**2,485,315**	**2,616,397**

[1] Deposits by States cover the benefit part of the program. Federal unemployment receipts cover administrative costs at both the Federal and State levels. Railroad unemployment receipts cover both the benefits and adminstrative costs of the program for the railroads.

[2] Represents employer and employee contributions to the civil service retirement and disability fund for covered employees of Government-sponsored, privately owned enterprises and the District of Columbia municipal government.

[3] Includes both Federal and trust funds.

[4] These amounts reflect an additional adjustment to receipts beyond what the economic and tax models forecast and have been made in the interest of cautious and prudent forecasting.

17. USER CHARGES AND OTHER COLLECTIONS

In addition to collecting taxes and other receipts by the exercise of its sovereign powers, which is discussed in the previous chapter, the Federal Government collects income from the public from market-oriented activities and the financing of regulatory expenses. These collections are classified as user charges, and they include the sale of postage stamps and electricity, charges for admittance to national parks, premiums for deposit insurance, and proceeds from the sale of assets, such as rents and royalties for the right to extract oil from the Outer Continental Shelf.

Depending on the laws that authorize the collections, they are credited to expenditure accounts as “offsetting collections,” or to receipt accounts as “offsetting receipts.” The budget refers to these amounts as “offsetting” because they are subtracted from gross outlays rather than added to taxes on the receipts side of the budget. The purpose of this treatment is to produce budget totals for receipts, outlays, and budget authority in terms of the amount of resources allocated governmentally, through collective political choice, rather than through the market.[1]

Usually offsetting collections are authorized to be spent for the purposes of the account without further action by the Congress. Offsetting receipts may or may not be earmarked for a specific purpose, depending on the legislation that authorizes them. When earmarked, the authorizing legislation may either authorize them to be spent without further action by the Congress, or require them to be appropriated in annual appropriations acts before they can be spent.

Offsetting collections and receipts include most user charges, which are discussed below, as well as some amounts that are not user charges. Table 17–1 summarizes these transactions. For 2005, total offsetting collections and receipts from the public are estimated to be $240.0 billion, and total user charges are estimated to be $182.2 billion.

The following section discusses user charges and the Administration’s user charge proposals. The subsequent section displays more information on offsetting collections and receipts. The offsetting collections and receipts by agency are displayed in Table 20–1, “Outlays to the Public, Net and Gross,” which appears in Chapter 20 of this volume.

Table 17–1. GROSS OUTLAYS, USER CHARGES, OTHER OFFSETTING COLLECTIONS AND RECEIPTS FROM THE PUBLIC, AND NET OUTLAYS

(in billions)

	Actual 2003	Estimate	
		2004	2005
Gross outlays	2,389.0	2,556.6	2,639.9
Offsetting collections and receipts from the public:			
User charges [1]	159.6	169.6	179.4
Other	71.7	68.2	60.6
Subtotal, offsetting collections and receipts from the public	231.3	237.8	240.0
Net outlays	2,157.6	2,318.8	2,399.8

[1] Total user charges are shown below. They include user charges that are classified on the receipts side of the budget in addition to the amounts shown on this line. For additional details of total user charges, see Table 17–2, “Total User Charge Collections.”

Total user charges:			
Offsetting collections and receipts from the public	159.6	169.6	179.4
Receipts	2.6	2.8	2.9
Total, User charges	162.2	172.3	182.2

[1] Showing collections from business-type transactions as offsets on the spending side of the budget follows the concept recommended by the *1967 Report of the President’s Commission on Budget Concepts.* The concept is discussed in Chapter 25: “The Budget System and Concepts” in this volume.

USER CHARGES

I. Introduction and Background

The Federal Government may charge those who benefit directly from a particular activity or those subject to regulation. Based on the definition used in this chapter, Table 17–2 shows that user charges were $162.2 billion in 2003, and are estimated to increase to $172.3 billion in 2004 and to $182.2 billion in 2005, growing to an estimated $208.2 billion in 2009, including the user charges proposals that are shown in Table 17–3. This table shows that the Administration's user charge proposals, including extension of expiring proposals, would increase user charges by an estimated $2.3 billion in 2005, growing to an estimated $7.5 billion in 2009.

Definition. User charges are fees, charges, and assessments levied on individuals or organizations directly benefiting from, or subject to regulation by, a government program or activity. In addition, the payers of the charge must be limited to those benefiting from, or subject to regulation by, the program or activity, and may not include the general public or a broad segment of the public (such as those who pay income taxes or customs duties).

- Examples of business-type or market-oriented user charges include charges for the sale of postal services (the sale of stamps), electricity (e.g., sales by the Tennessee Valley Authority), proceeds from the sale of goods by defense commissaries, payments for Medicare voluntary supplemental medical insurance, life insurance premiums for veterans, recreation fees for parks, the sale of weather maps and related information by the Department of Commerce, and proceeds from the sale of assets (property, plant, and equipment) and natural resources (such as timber, oil, and minerals).
- Examples of regulatory and licensing user charges include charges for regulating the nuclear energy industry, bankruptcy filing fees, immigration fees, food inspection fees, passport fees, and patent and trademark fees.

The "user charges" concept used here aligns these estimates with the concept that establishes policy for charging prices to the public for the sale or use of goods, services, property, and resources (see OMB Circular No. A–25, "User Charges," July 8, 1993).

User charges do not include all offsetting collections and receipts from the public, such as repayments received from credit programs; interest, dividends, and other earnings; payments from one part of the Federal Government to another; or cost sharing contributions. Nor do they include earmarked taxes (such as taxes paid to social insurance programs or excise taxes on gasoline), or customs duties, fines, penalties, and forfeitures.

Alternative definitions. The definition used in this chapter is useful because it is similar to the definition used in OMB Circular No. A–25, "User Charges," which provides policy guidance to Executive Branch agencies on setting prices for user charges. Alternative definitions may be used for other purposes. Much of the discussion of user charges below—their purpose, when they should be levied, and how the amount should be set—applies to these alternatives as well.

Other definitions of user charges could, for example:

- be narrower than the one used here, by limiting the definition to proceeds from the sale of goods and services (and excluding the sale of assets), and by limiting the definition to include only proceeds that are earmarked to be used specifically to finance the goods and services being provided. This definition is similar to one the House of Representatives uses as a guide for purposes of committee jurisdiction. The definition helps differentiate between taxes, which are under the jurisdiction of the Ways and Means Committee, and fees, which can be under the jurisdiction of other committees. (See the Congressional Record, January 3, 1991, p. H31, item 8.)
- be even narrower than the user fee concept described above, by excluding regulatory fees and focusing solely on business-type transactions.
- be broader than the one used in this chapter by including beneficiary- or liability-based excise taxes, such as gasoline taxes. [2]

What is the purpose of user charges? The purpose of user charges is to improve the efficiency and equity of certain Government activities, and to reduce the burden on taxpayers to finance activities whose benefits accrue to a relatively limited number of people, or to impose a charge on activities that impose a cost on the public.

User charges that are set to cover the costs of production of goods and services can provide efficiency in the allocation of resources within the economy. They allocate goods and services to those who value them the most, and they signal to the Government how much of the goods or services it should provide. Prices in private, competitive markets serve the same purposes.

User charges for goods and services that do not have special social benefits improve equity, or fairness, by requiring that those who benefit from an activity are the same people who pay for it. The public often perceives user charges as fair because those who benefit from the good or service pay for it in whole or in part, and those who do not benefit do not pay.

[2] Beneficiary- and liability-based taxes are terms taken from the Congressional Budget Office, *The Growth of Federal User Charges,* August 1993, and updated in October 1995. In addition to gasoline taxes, examples of beneficiary-based taxes include taxes on airline tickets, which finance air traffic control activities and airports. An example of a liability-based tax is the excise tax that formerly helped fund the hazardous substance superfund in the Environmental Protection Agency. This tax was paid by industry groups to finance environmental cleanup activities related to the industry activity but not necessarily caused by the payer of the fee.

When should the Government charge a fee? Discussions of whether to finance spending with a tax or a fee often focus on whether the benefits of the activity are to the public in general or to a limited group of people. In general, if the benefits accrue broadly to the public, then the program should be financed by taxes paid by the public; in contrast, if the benefits accrue to a limited number of private individuals or organizations, then the program should be financed by charges paid by the private beneficiaries. For Federal programs where the benefits are entirely public or entirely private, applying this principle is relatively easy. For example, according to this principle, the benefits from national defense accrue to the public in general and should be (and are) financed by taxes. In contrast, the benefits of electricity sold by the Tennessee Valley Authority accrue exclusively to those using the electricity, and should be (and are) financed by user charges.

In many cases, however, an activity has benefits that accrue to both public and to private groups, and it may be difficult to identify how much of the benefits accrue to each. Because of this, it can be difficult to know how much of the program should be financed by taxes and how much by fees. For example, the benefits from recreation areas are mixed. Fees for visitors to these areas are appropriate because the visitors benefit directly from their visit, but the public in general also benefits because these areas protect the Nation's natural and historical heritage now and for posterity.

As a further complication, where a fee may be appropriate to finance all or part of an activity, some consideration must be given to the ease of administering the fee.

What should be the amount of the fee? For programs that have private beneficiaries, the amount of the charge should depend on the costs of producing the goods or services and the portion of the program that is for private benefits. If the benefit is primarily private, and any public benefits are incidental, current policies support charges that cover the full cost to the Government, including both direct and indirect costs.[3]

The Executive Branch is working to put cost accounting systems in place across the Government that would make the calculation of full cost more feasible. The difficulties in measuring full cost are associated in part with allocating to an activity the full costs of capital, retirement benefits, and insurance, as well as other Federal costs that may appear in other parts of the budget. Guidance in the Statement of Federal Financial Accounting Standards No. 4, Managerial Cost Accounting Concepts and Standards for the Federal Government (July 31, 1995), should underlie cost accounting in the Federal Government.

Classification of user charges in the budget. As shown in Table 17–1, most user charges are classified as offsets to outlays on the spending side of the budget, but a few are classified on the receipts side of the budget. An estimated $2.9 billion in 2005 are classified this way and are included in the totals described in Chapter 16. "Federal Receipts." They are classified as receipts because they are regulatory charges collected by the Federal Government by the exercise of its sovereign powers. Examples include filing fees in the United States courts, agricultural quarantine inspection fees, and passport fees.

The remaining user charges, an estimated $179.4 billion in 2005, are classified as offsetting collections and receipts on the spending side of the budget. Some of these are collected by the Federal Government by the exercise of its sovereign powers and would normally appear on the receipts side of the budget, but are required by law to be classified on the spending side as offsetting collections or receipts.

An estimated $124.3 billion of user charges for 2005 are credited directly to expenditure accounts, and are generally available for expenditure when they are collected, without further action by the Congress. An estimated $55.1 billion of user charges for 2005 are deposited in offsetting receipt accounts, and are available to be spent only according to the legislation that established the charges.

As a further classification, the accompanying Tables 17–2 and 17–3 identify the user charges as discretionary or mandatory. These classifications are terms from the Budget Enforcement Act of 1990 as amended and are used frequently in the analysis of the budget. "Discretionary" in this chapter refers to user charges generally controlled through annual appropriations acts and under the jurisdiction of the appropriations committees in the Congress. "Mandatory" refers to user charges controlled by permanent laws and under the jurisdiction of the authorizing committees.

These and other classifications are discussed further in this volume in Chapter 25, "The Budget System and Concepts."

II. Total User Charges

As shown in Table 17–2, total user charge collections (including those proposed in this budget) are estimated to be $182.2 billion in 2005, increasing to $208.2 billion in 2009. User charge collections by the Postal Service and for Medicare premiums are the largest and are estimated to be more than half of total user charge collections in 2005.

[3] Policies for setting user charges are promulgated in OMB Circular No. A–25: "User Charges" (July 8, 1993).

Table 17–2. TOTAL USER CHARGE COLLECTIONS

(in millions of dollars)

	Actual 2003	Estimates					
		2004	2005	2006	2007	2008	2009
Receipts							
Agricultural quarantine inspection fees	231	260	274	272	279	287	294
Abandoned mine reclamation fund	282	278	239	245	252	256	262
Department of State immigration, passport, and consular fees	642	634	627	651	675	702	729
Corps of Engineers harbor maintenance fees	758	812	886	965	1,036	1,051	1,074
Other	705	770	825	831	838	635	635
Subtotal, receipts	2,618	2,754	2,851	2,964	3,080	2,931	2,994
Offsetting Collections and Receipts from the Public							
Discretionary							
Department of Agriculture: Food safety inspection and other fees	106	140	308	305	307	310	312
Department of Commerce: Patent and trademark, fees for weather services, and other fees	1,395	1,506	1,767	1,900	2,013	2,135	2,222
Department of Defense: Commissary and other fees	7,309	9,008	9,098	10,770	10,534	10,534	10,534
Department of Energy: Federal Energy Regulation Commission, power marketing, and other fees	915	1,069	1,729	1,710	1,716	1,729	1,731
Department of Health and Human Services: Food and Drug Administration, Centers for Medicare and Medicaid Services, and other fees	891	771	974	963	966	968	970
Department of Homeland Security: Border and Transportation Security and other fees	1,558	2,387	2,510	2,639	2,771	2,909	3,044
Department of the Interior: Minerals Management Service and other fees	306	291	360	347	338	356	354
Department of Justice: Fees for bankruptcy oversight and other fees	265	266	306	298	299	301	301
Department of State: Passport and other fees	877	949	1,222	1,260	1,312	1,363	1,413
Department of Transportation: Motor carrier safety and other fees	84	100	101	104	105	107	109
Department of the Treasury: Sale of commemorative coins and other fees	1,393	1,518	1,580	1,540	1,542	1,550	1,553
Department of Veterans Affairs: Medical care and other fees	1,626	1,989	2,531	2,647	2,773	2,905	3,044
Social Security Administration, State supplemental fees, supplemental security income	107	120	121	118	118	119	119
Federal Communications Commission: Regulatory fees	363	358	364	355	355	357	357
Federal Trade Commission: Regulatory fees	61	135	170	183	188	191	194
Nuclear Regulatory Commission: Regulatory fees	526	546	541	532	535	541	545
Securities and Exchange Commission: Regulatory fees	1,000	1,547	1,806	2,146	1,115	1,147	1,332
All other agencies, discretionary user fees	654	430	588	576	589	599	600
Subtotal, discretionary user charges	19,436	23,130	26,076	28,393	27,576	28,121	28,734
Mandatory							
Department of Agriculture: Crop insurance and other fees	1,469	1,878	1,800	1,879	1,912	1,927	1,938
Department of Defense: Commissary surcharge and other fees	690	694	661	593	484	475	441
Department of Energy: Proceeds from the sale of energy, nuclear waste disposal fees, and other fees	4,829	4,945	4,055	4,132	3,966	4,021	4,098
Department of Health and Human Services: Medicare Part B insurance premiums, and other fees	28,466	32,253	36,926	38,904	40,196	42,601	45,171
Department of Homeland Security: Customs, immigration, and other fees	4,888	5,131	5,677	5,784	5,971	6,159	6,357
Department of the Interior: Recreation and other fees	2,941	3,359	4,077	3,434	3,442	3,531	3,397
Department of Justice: Federal Prison Commissary fees and other fees	295	361	403	409	374	380	386
Department of Labor: Insurance premiums to guaranty private pensions and other fees	1,490	2,605	3,005	3,220	3,662	3,579	3,642
Department of the Treasury: Bank regulation, and other fees	712	747	848	858	867	883	901
Department of Veterans Affairs: Veterans life insurance and other fees	1,857	1,674	1,633	1,586	1,542	1,509	1,483
Office of Personnel Management: Federal employee health and life insurance fees	8,951	9,937	10,696	11,360	12,162	13,117	14,014
Federal Deposit Insurance Corporation: Deposit insurance fees	1,655	1,351	1,153	1,431	2,516	3,972	4,672
National Credit Union Administration: Credit union share insurance and other fees	508	556	566	483	512	544	578
Postal Service: Fees for postal services	67,752	67,916	68,134	68,885	69,575	70,265	70,955
Tennessee Valley Authority: Proceeds from the sale of energy	7,255	7,513	7,959	7,997	8,104	8,147	8,242
Allowances, spectrum relocation fund	....	....	....	1,250	1,250	....	....
Undistributed Offsetting Receipts: Sale of spectrum licenses, OCS receipts, and other fees	5,029	4,587	4,855	17,382	15,465	8,918	9,290
All other agencies, mandatory user fees	1,380	925	860	904	919	926	923
Subtotal, mandatory user charges	140,167	146,432	153,308	170,491	172,919	170,954	176,488
Subtotal, user charges that are offsetting collections and receipts from the public	159,603	169,562	179,384	198,884	200,495	199,075	205,222
TOTAL, User charges	162,221	172,316	182,235	201,848	203,575	202,006	208,216

III. User Charge Proposals

As shown in Table 17–3, the Administration is proposing new or increased user charges, including proposed extensions of expiring charges, that would increase collections by an estimated $2.3 billion in 2005, increasing to $7.5 billion in 2009.

A. User Charge Proposals to Offset Discretionary Spending

1. Offsetting collections

Department of Agriculture

Food Safety and Inspection Service.—The Administration proposes a new user fee for the Food Safety and Inspection Service (FSIS). Under the proposed fee, the meat, poultry and egg industries would be required to reimburse the Federal Government for the full cost of extra shifts for inspection services. FSIS would cover the cost of a primary eight hour shift and the establishments would pay for additional complete work shifts. Currently, establishments pay for overtime when it is less than one complete shift.

The Grain Inspection, Packers, and Stockyards Administration (GIPSA).—GIPSA proposes to establish a fee to cover the cost associated with GIPSA's standardization activities and a licensing fee to cover the cost associated with administering meat packers and stockyards activities.

Animal and Plant Health Inspection Service.—Legislation will be proposed to establish user fees for animal welfare inspections, such as for animal research centers, humane societies and kennels.

Table 17–3. USER CHARGE PROPOSALS

(estimated collections in millions of dollars)

	2005	2006	2007	2008	2009	2005–2009
DISCRETIONARY						
1. Offsetting collections						
Department of Agriculture						
Food Safety Inspection user fees	124	121	121	122	122	610
Grain Inspection, Packers and Stockyards Administration	29	28	28	28	29	142
Animal and Plant Health Inspection Service	11	11	11	11	11	55
Department of Commerce						
Patent and Trademark Office	219	264	311	360	383	1,537
Department of Energy						
Office of Civilian Radioactive Waste Management: Reclassify fees	749	754	757	767	767	3,794
Department of Health and Human Services						
Medicare duplicate or unprocessable claims	195	195	195	195	195	975
Medicare appeals reform	10	32	33	34	35	144
Department of the Interior						
Fees transferred from the Power Marketing Administrations	30	29	29	29	29	146
Department of Justice						
FBI fees for forensic services	39	35	33	33	31	171
DEA fees for forensic services	3	3	3	3	3	15
Department of State						
Enhanced border security program user fees	100	105	111	116	122	554
Department of Transportation						
Motor carrier safety	13	13	13	13	13	65
Corps of Engineers—Civil Works						
Fees transferred from the Power Marketing Administrations	150	156	160	165	172	803
2. Offsetting receipts						
Department of Housing and Urban Development						
Office of Federal Housing Enterprise Oversight: GSE regulation	–44	–44	–45	–47	–47	–227
Department of Veterans Affairs						
Annual enrollment fee	268	281	295	310	326	1,480
Higher drug copayments	135	142	149	156	165	747
Environmental Protection Agency						
Abolish cap on pre-manufacturing notification fees	4	8	8	8	8	36
Remove prohibition on collection of registration fees	26	27	27	28	28	136
Nuclear Regulatory Commission						
Extend Nuclear Regulatory Commission fees	....	330	329	330	329	1,318
Subtotal, discretionary user charges proposals	2,061	2,490	2,568	2,661	2,721	12,501

Table 17–3. USER CHARGE PROPOSALS—Continued

(estimated collections in millions of dollars)

	2005	2006	2007	2008	2009	2005–2009
MANDATORY						
1. Offsetting collections						
Department of Housing and Urban Development						
Government-sponsored enterprise regulation	6	6	6	6	6	30
Department of the Treasury						
Government-sponsored enterprise regulation	83	81	81	82	82	409
Federal Deposit Insurance Corporation						
Deposit insurance premiums	....	–570	–744	58	59	–1,197
Federal Housing Finance Board						
Government-sponsored enterprise regulation	–34	–32	–34	–35	–36	–171
2. Offsetting receipts						
Department of Agriculture						
Forest Service recreation fees	....	37	50	50	55	192
Department of Energy						
Office of Civilian Radioactive Waste Management: Reclassify fees	–749	–754	–757	–767	–767	–3,794
Fees transferred from the Power Marketing Administrations	–180	–186	–191	–197	–204	–958
Arctic National Wildlife Refuge, collections for research and development	....	1,200	....	....	....	1,200
Department of Homeland Security						
Conveyance and passenger fees and merchandise processing fees	820	1,391	1,448	1,507	1,570	6,736
Department of the Interior						
Recreation fees	....	38	48	47	47	180
Hetch Hetchy rental payments	8	8	8	8	8	40
Bureau of Land Management land sale authority	24	33	38	48	48	191
Arctic National Wildlife Refuge, collection for payments to Alaska	....	1,201	1	101	1	1,304
Arctic National Wildlife Refuge, rents and bonuses	....	1	1	101	1	104
Department of Labor						
Application fee for the permanent foreign labor certification program	23	23	23	23	23	115
Corps of Engineers—Civil Works						
Special recreation user fees	7	7	7	7	7	35
Federal Communications Commission						
Analog spectrum fee	....	....	500	500	480	1,480
Extend auction authority	....	....	–2,000	–2,000	2,800	–1,200
Spectrum license user fees	....	50	150	300	300	800
Subtotal, mandatory user charges proposals	8	2,534	–1,365	–161	4,480	5,496
3. Governmental receipts						
Department of the Interior						
Extend abandoned mine reclamation fees	239	245	252	256	262	1,254
National Indian Gaming Commission, activity fees	....	4	4	5	5	18
Department of the Treasury						
Internal Revenue Service fees	32	44	45	46	47	214
Subtotal, governmental receipts user charges proposals	271	293	301	307	314	1,486
Total, User charges proposals	2,340	5,317	1,504	2,807	7,515	19,483

Department of Commerce

Patent and Trademark Office (PTO).—The Administration continues to support legislation proposed with the *2004 Budget* to restructure patent fees and adjust trademark fees in support of the objectives of PTO's strategic plan to enhance examination quality, improve the efficiency of the patent and trademark examination systems, and better reflect the agency's costs.

Department of Energy

Office of Civilian Radioactive Waste Management—reclassify fees.—The Administration proposes legislation to reclassify fees currently paid to the Federal government by utilities that generate electricity using nuclear power. Fees equal to the amount appropriated would be credited as offsets to appropriations for the U.S. nuclear waste management program and their classification would be changed from mandatory to discretionary. The Department of Energy will require substantial additional resources to complete the application process and construct the nuclear waste repository at Yucca Mountain, Nevada. This new funding mechanism will ensure that adequate funds are available for the repository to begin to accept waste in 2010.

Department of Health and Human Services

Medicare duplicate or unprocessable claims.—The Administration proposes new user fees for providers submitting duplicate or unprocessable claims. The Centers for Medicare and Medicaid Services (CMS) and its contractors go to great lengths to ensure that providers are aware of billing requirements and the need to submit accurate claims. Charging a fee for duplicate or unprocessable claims would heighten provider awareness of these issues and increase efficiency by deterring this action.

Medicare appeals reform.—The Medicare, Medicaid, and SCHIP (State Children's Health Insurance Program) Benefits Improvement and Protection Act of 2000 and Medicare Prescription Drug, Improvement, and Modernization Act of 2003 require CMS to reform the current Medicare appeals process. The Administration proposes a modest filing fee for providers who submit Medicare appeals to Qualified Independent Contractors, which represent a new level of adjudication. This proposal would heighten provider awareness of a reformed appeals process and requirements as well as deter appeals submitted with inaccurate or insufficient information.

Department of the Interior

Fees transferred from the Power Marketing Administrations.—Beginning in 2005, the Administration proposes that the Western Area Power Administration (WAPA) transfer receipts to directly finance hydropower-related operation and maintenance expenses of the Bureau of Reclamation in the Department of the Interior in those areas where pre-existing direct financing arrangements are not already in place. These receipts are derived from the sale of power and related services. This proposal transfers WAPA receipts to the Bureau of Reclamation equivalent to its operating and maintenance costs for the facilities in these areas. The Bureau of Reclamation already has a similar arrangement with the Bonneville Power Administration.

Department of Justice

Federal Bureau of Investigation (FBI) fees for forensic services.—The Administration proposes a new user fee associated with providing forensic support to State and local law enforcement agencies. Historically, requests from State and local law enforcement agencies comprise 25 to 30 percent of the forensic caseload of the FBI Laboratory. These services are currently provided at no cost. This significant expense to the FBI would be partially offset by the new user fee, which will be structured to minimize its impact, particularly on small State and local law enforcement agencies.

Drug Enforcement Administration (DEA) fees for forensic services.—The Administration proposes a new user fee associated with providing forensic support to the Metropolitan Police Department of the District of Columbia (MPD). In 2002, 64 percent of the drug exhibits analyzed by DEA's Mid-Atlantic Laboratory were submitted by the MPD. These services are currently provided at no cost. The Mid-Atlantic Laboratory is the only DEA laboratory where the workload for State and local law enforcement agencies exceeds one percent. The proposed fees would be structured to offset these costs.

Department of State

Enhanced border security program user fees.—The Department of State is strengthening the security of its adjudication processes and documents as well as striving to meet all biometric-related requirements on time. In order to address all border security requirements, in addition to the fees currently collected and retained by the Department, the Administration is proposing the collection and retention of additional resources in 2005.

Department of Transportation

Motor carrier safety.—The Federal Motor Carrier Safety Administration collects registration and insurance validation fees from motor carriers applying to operate in interstate commerce. Carrier registration and proof of insurance are necessary for trucking firms to obtain Department of Transportation numbers for interstate operations. These fees are primarily used to fund the processing of carrier registration and insurance actions by the agency's Licensing and Insurance Divisions.

Corps of Engineers—Civil Works

Fees transferred from the Power Marketing Administrations (PMAs).—The Administration proposes that, starting in 2005, receipts from the sale of hydroelectric power generated at certain Federal dams operated by Corps of Engineers be used to finance the operation and maintenance of those facilities. This direct financing arrangement already exists for the Bonneville Power Administration, and the proposal would extend it to the Southeastern, Southwestern, and Western Power Administrations in the Department of Energy. Replacing the current Corps of Engineers appropriations for these activities with direct funding from user fees will make it easier to ensure that adequate funding is provided for operations and maintenance of these facilities.

2. *Offsetting receipts*

Department of Housing and Urban Development

Office of Federal Housing Enterprise Oversight: GSE regulation.—This proposal is discussed in the entry for the Department of the Treasury below that discusses government-sponsored enterprise regulation.

Department of Veterans Affairs

Establish an annual enrollment fee and increased pharmaceutical copayments for PL 7 and PL 8 veterans (non-disabled, higher income).—Legislation will be proposed to establish an annual enrollment fee of $250 and an increased pharmaceutical copayment of $15 for Priority Level 7 and 8 veterans. The increased receipts will allow the Department of Veterans Affairs to refocus the medical care system on caring for its core population—veterans with special needs, service-connected disabilities, and lower incomes.

Environmental Protection Agency

Abolish cap on pre-manufacturing notification fees.—EPA collects fees from chemical manufacturers seeking to bring new chemicals into commerce. These fees are authorized by the Toxic Substances Control Act and are now subject to an outdated statutory cap. The Administration is proposing appropriations language to modify the cap so that EPA can increase fees to fully cover the cost of the program.

Remove prohibition on collection of registration fees.—The Administration is proposing to remove a prohibition on the collection of pesticide registration fees. These fees will be collected from entities seeking to register their pesticides for use in the United States.

Nuclear Regulatory Commission

Extend Nuclear Regulatory Commission (NRC) fees at their 2005 level for 2006 and later.—The Omnibus Budget Reconciliation Act (OBRA) of 1990, as amended, required that the NRC assess license and annual fees that recover approximately 90 percent of its budget authority in 2005, less the appropriation from the Nuclear Waste Fund. Licensees are required to reimburse NRC for its services, because licensees benefit from such services. After 2005, the recovery requirement reverts to 33 percent per year. If the 90 percent requirement is not extended beyond 2005, fees would drop from an estimated $541 million in 2005 to $202 million in 2006. With an extension at 90 percent, fees would be an estimated $532 million in 2006, an increase of $330 million.

B. User Charge Proposals to Offset Mandatory Spending

1. *Offsetting collections*

Department of Health and Human Services

Child support enforcement fees for never-TANF cases.—The Administration is re-proposing legislative proposals from the 2003 and 2004 budgets to mandate an annual user fee of $25 for child support cases for people who have never been on assistance (temporary assistance for needy families (TANF), aid to families with dependent children, or Medicaid). The Federal and State governments would share in the savings proportional to the Federal Financial Participation rate. This fee would be collected by State governments.

Department of Housing and Urban Development

Government-sponsored enterprise (GSE) regulation.—The Administration has proposed broad reform of the supervisory system for government-sponsored enterprises (GSEs) in the housing market. Part of this reform includes the assessment on Fannie Mae and Freddie Mac of the cost of HUD's responsibilities under the Federal Housing Enterprise Safety and Soundness Act of 1992 and amendments as proposed. These responsibilities include the establishment and enforcement of affordable housing goals for the GSEs, ensuring GSE compliance with fair housing laws, and providing consultation to the safety and soundness regulator on the GSEs' new activities. (For additional information see Chapter 7, "Credit and Insurance" in this volume, and the Department of Housing and Urban Development chapter in the Appendix volume.)

Department of the Treasury

Government-sponsored enterprise (GSE) regulation.—The Administration has proposed broad reform of the supervisory system for government-sponsored enterprises (GSEs) in the housing market. Fees currently collected by the Office of Federal Housing Enterprise Oversight and the Federal Housing Finance Board would instead be collected by a new housing GSE safety and soundness regulator in the Department of the Treasury. (For additional information, see Chapter 7, "Credit and Insurance", in this volume, and the Department of Treasury chapter in the Appendix volume.)

Federal Deposit Insurance Corporation

Deposit insurance premiuns.—The Federal Deposit Insurance Corporation (FDIC) insures deposits in bank and savings associations (thrifts) through the Bank Insurance Fund (BIF) and the Savings Association Fund (SAIF). This budget proposes to merge the BIF and the SAIF, which offer an identical product. The FDIC maintains a reserve ratio of insurance fund reserves to total insured deposits of 1.25 percent. If insurance fund reserves fall below 1.25 percent, the FDIC will charge sufficient premiums to restore the reserve ratio to 1.25 percent. The Administration's *2005 Budget* assumes that some premium fees will be required to maintain the reserve ratio in 2006 and beyond.

Federal Housing Finance Board

Government-sponsored enterprise (GSE) regulation.—This proposal is discussed above in the entry for the Department of the Treasury.

2. *Offsetting receipts*

Department of Agriculture

Forest Service recreation fees.—A recreation fee program is proposed, generally consistent with the existing recreation fee demonstration program, that would permanently authorize the direct expenditure of recreations fees collected by the Forest Service and the Department of the Interior beginning in 2005.

Department of Energy

Office of Civilian Radioactive Waste Management—reclassify fees.—This proposal is discussed under the discretionary Department of Energy proposal above.

Fees transferred from the Power Marketing Administration (PMAs).—Beginning in 2005, the Administration proposes that financing of the hydropower-related operation and maintenance costs of the Bureau of Reclamation in the Department of the Interior and the Corps of Engineers be directly funded by receipts from the PMAs—Southeastern, Southwestern, and Western Area Power Administrations—in those areas where pre-existing direct financing arrangements are not already in place. These receipts are derived from the sale of power and related services. This proposal would transfer receipts to the Bureau of Reclamation and to the Corps of Engineers equivalent to their operating and maintenance costs for the facilities in these areas. The Bureau of Reclamation already has similar arrangements with other entities, such as the Bonneville Power Administration.

Arctic National Wildlife Refuge, collections for research and development.—The budget includes a proposal to authorize the Department of the Interior to conduct environmentally responsible oil and gas exploration and development within a small area of the Arctic National Wildlife Refuge, sometimes referred to as the "1002 Area," located in northern Alaska. The Department of the Interior estimates that recoverable oil from this area is between 5.7 and 16 billion barrels of oil. The budget assumes that the first oil and gas lease sale would be held in 2006 and would result in $2.4 billion in new revenues. Beginning in 2006 the budget would dedicate one-half of the first lease sale, $1.2 billion, to fund increased research and development on renewable energy and related technology by the Department of Energy over a seven-year period. All oil and gas revenues from the 1002 Area would be shared fifty percent with the State of Alaska, including the estimated $2 million annual rental payments.

Department of Homeland Security

Conveyance and passenger fees and merchandise processing fees.—The Administration proposes the reauthorization of two user fees; the Bureau of Customs and Border Protection (BCBP) conveyance and passenger fees, and the merchandise processing fee. BCBP currently collects multiple different conveyance and passenger user fees under the Consolidated Omnibus Budget Reconciliation Act (COBRA) of 1985 and related statutes and a merchandise processing fee established by the Omnibus Budget Reconciliation Act (OBRA) of 1986, all of which are set to expire on March 1, 2005.

Department of the Interior

Recreation fees.—The Administration proposal gives permanent authority for bureaus in the Department of the Interior (DOI) to collect and spend the receipts from entrance and other recreation fees. DOI's National Park Service, Fish and Wildlife Service, and Bureau of Land Management are currently authorized to do so through 2005 under the recreation fee demonstration program.

Hetch Hetchy rental payments, Yosemite Management Fund.—This legislative proposal would authorize the National Park Service to charge rental payments to the City of San Francisco for the Hetch Hetchy Reservoir in Yosemite National Park. The proposal would also authorize NPS to retain and expend the receipts, without further appropriations, for activities in Yosemite National Park.

Bureau of Land Management's (BLM's) land sale authority.—The Administration will propose legislation to amend BLM's land sale authority under the Federal Land Transaction Facilitation Act (FLTFA) to: (1) allow BLM to use updated management plans to identify areas suitable for disposal; (2) allow a portion of the receipts to be used by BLM for restoration projects; (3) cap receipt retention at $100 million per year; (4) extend the authority to 2015; and (5) eliminate the use of receipts for land exchanges. BLM is currently limited to selling lands that had been identified for disposal in land use plans that were in effect prior to enactment of FLTFA. Use of the receipts is currently limited to the purchase of other lands for conservation purposes.

Arctic National Wildlife Refuge, collections for payments to Alaska.—The budget includes a proposal to authorize the Department of the Interior to conduct environmentally responsible oil and gas exploration and development within a small area of the Arctic National Wildlife Refuge, sometimes referred to as the "1002 Area," located in northern Alaska. This proposal is discussed under the Department of Energy above.

Department of Labor

Application fee for the permanent foreign labor certification program.—Legislation will be proposed to establish a fee for applicants to the Permanent Foreign Labor Certification Program. This fee, which would cover the cost of processing new applications, also would partially support the administrative costs of backlog reduction in the State and regional offices.

Corps of Engineers—Civil Works

Special recreation user fees.—The Corps of Engineers manages 4,300 recreation areas at 456 Corps projects (mostly lakes) in 43 states, used annually by millions of visitors. The Administration proposes that the Corps participate in the existing Federal Recreation User Fee Demonstration project and undertake six recreation demonstration projects. This will allow the agency to use the additional user fees it collects to modernize and upgrade boating, camping and other outdoor recreation facilities at the sites where the fees are collected. The initiative will improve the quantity and quality of recreation services available to the public.

Federal Communications Commission

Analog spectrum fee.—To encourage television broadcasters to vacate the analog spectrum after 2006, as required by law, the Administration continues to support proposals authorizing the Federal Communications Commission (FCC) to establish an annual lease fee totaling $500 million for the use of analog spectrum by commercial broadcasters beginning in 2007. Upon return of their analog spectrum license to the FCC, individual broadcasters will be exempt from the fee, and fee collections would decline.

Extend auction authority.—The Administration continues to support proposals to extend indefinitely the FCC's authority to auction spectrum licenses, which expires in 2007. Reductions in estimated receipts in 2007 and 2008 resulting from possible shifting of spectrum auctions from 2007 into later years are more than offset by higher estimated receipts for those auctions in 2009 and 2010 as well as future new auctions. Estimated additional receipts from this proposal are $2.4 billion over the next ten years.

Spectrum license user fees.—To continue to promote efficient spectrum use, the Administration continues to support proposals for new authority for the FCC to set user fees on unauctioned spectrum licenses, based on public-interest and spectrum-management principles. Fee collections are estimated to begin in 2006 and total $3.1 billion in the first nine years.

3. Governmental receipts

Department of the Interior

Extend abandoned mine reclamation fees.—Collections from abandoned mine reclamation fees are allocated to States for reclamation grants. Current fees of 35 cents per ton for surface mined coal, 15 cents per ton for underground mined coal, and 10 cents per ton for lignite coal are scheduled to expire on September 30, 2004. Abandoned land problems are expected to exist in certain States after all the money from the collection of fees under current law is expended. The Administration proposes to extend these fees at a reduced rate to clean up and reclaim the most significant abandoned mine land problems in 25 years. The Administration also proposes to modify the authorization language to allocate more of the receipts collected toward restoration of abandoned coal mine land.

National Indian Gaming Commission, activity fees.—The National Indian Gaming Commission regulates and monitors gaming operations conducted on Indian lands. Since 1998, there has been a fixed cap on the annual fees the Commission may assess gaming operations to cover the costs of its oversight responsibilities. The Administration proposes to amend the current fee structure so that the Commission can adjust its activities to the growth in the Indian gaming industry.

Department of the Treasury

Permanently extend Internal Revenue Service (IRS) user fees.—The Administration proposes to permanently extend IRS authority to charge fees for written responses to questions from individuals, corporations, and organizations related to their tax status or the effects of particular transactions for tax purposes. Under current law, these fees are scheduled to expire effective with requests made after December 31, 2004.

OTHER OFFSETTING COLLECTIONS AND RECEIPTS

Table 17–4 shows the distribution of user charges and other offsetting collections and receipts according to whether they are offsetting collections credited to expenditure accounts or offsetting receipts. The table shows that total offsetting collections and receipts from the public are estimated to be $240.0 billion in 2005. Of these, an estimated $150.6 billion are offsetting collections credited to appropriation accounts and an estimated $89.4 billion are deposited in offsetting receipt accounts.

Information on the user charges presented in Table 17–4 is available in Tables 17–2 and 17–3 and the discussion that accompanies those tables. Major offsetting collections deposited in expenditure accounts that are not user charges include collections by the Commodity Corporation fund in the Department of Agriculture, which are related to loans, collections from States to supplement payments in the supplemental security income program, and pre-credit reform loan repayments. Major offsetting receipts that are not user charges include military assistance program sales and interest income.

Table 17–5 includes all offsetting receipts deposited in receipt accounts. These include payments from one part of the Government to another, called intragovernmental transactions, and collections from the public. These receipts are offset (deducted) from outlays in the Federal budget. In total, offsetting receipts are estimated to be $539.1 billion in 2005: $449.6 billion are intragovernmental transactions; and $89.4 billion are from the public, shown in the table as proprietary receipts from the public and offsetting governmental receipts.

As noted above, offsetting collections and receipts by agency are also displayed in Table 20–1, “Outlays to the Public, Net and Gross,” which appears in Chapter 20 of this volume.

Table 17–4. OFFSETTING COLLECTIONS AND RECEIPTS FROM THE PUBLIC

(in millions of dollars)

	Actual 2003	Estimate	
		2004	2005
Offsetting collections credited to expenditure accounts:			
User charges:			
Postal service stamps and other postal fees	67,752	67,916	68,134
Defense Commissary Agency	5,064	5,118	5,161
Employee contributions for employees and retired employees health benefits funds	7,235	8,131	8,798
Sale of energy:			
Tennessee Valley Authority	7,255	7,513	7,959
Bonneville Power Administration	3,530	3,646	3,647
All other user charges	24,055	28,024	30,608
Subtotal, user charges	114,891	120,348	124,307
Other collections credited to expenditure accounts:			
Commodity Corporation fund	9,441	9,255	10,844
Supplemental security income (collections from the States)	3,925	4,229	4,314
Other collections	17,126	11,832	11,111
Subtotal, other collections	30,492	25,316	26,269
Subtotal, collections credited to expenditure accounts	145,383	145,664	150,576
Offsetting receipts:			
User charges:			
Medicare premiums	28,433	32,169	36,803
Outer Continental Shelf rents, bonuses, and royalties	5,029	4,587	4,755
All other user chaarges	11,250	12,458	13,519
Subtotal, user charges deposited in receipt accounts	44,712	49,214	55,077
Other collections deposited in receipt accounts:			
Military assistance program sales	10,454	11,974	10,882
Interest income	14,018	14,113	13,865
All other collections deposited in receipt accounts	16,752	16,799	9,608
Subtotal, other collections deposited in receipt accounts	41,224	42,886	34,355
Subtotal, collections deposited in receipt accounts	85,936	92,100	89,432
Total, offsetting collections and receipts from the public	**231,319**	**237,764**	**240,008**
Total, offsetting collections and receipts excluding off-budget	**163,473**	**169,738**	**171,761**
ADDENDUM:			
User charges that are offsetting collections and receipts [1]	159,603	169,562	179,384
Other offsetting collections and receipts from the public	71,716	68,202	60,624
Total, offsetting collections and receipts from the public	**231,319**	**237,764**	**240,008**

[1] Excludes user charges that are classified on the receipts side of the budget. For total user charges, see Table 17.1 or Table 17.2.

Table 17–5. OFFSETTING RECEIPTS BY TYPE

(In millions of dollars)

Source	2003 Actual	Estimate					
		2004	2005	2006	2007	2008	2009
INTRAGOVERNMENTAL TRANSACTIONS							
On-budget receipts:							
Federal intrafund transactions:							
Distributed by agency:							
Interest from the Federal Financing Bank	2,449	1,192	1,186	1,178	1,178	1,187	1,195
Interest on Government capital in enterprises	792	847	945	1,066	1,076	1,072	1,080
General fund payments to retirement and health benefits funds:							
DoD retiree health care fund	14,565	16,868	18,576	20,550	22,612	24,886	27,371
Other	3,218	2,419	2,642	2,718	2,800	2,851	2,991
Proposed Legislation (non-PAYGO)	....	....	8	15	28	41	51
Proposed Legislation (PAYGO)	....	6	6	6	6	6	6
Undistributed by agency:							
Employing agency contributions:							
DoD retiree health care fund	8,201	8,356	10,541	11,215	11,914	12,657	13,440
Total Federal intrafunds	29,225	29,688	33,904	36,748	39,614	42,700	46,134
Trust intrafund transactions:							
Distributed by agency:							
Payments to railroad retirement	23,233	6,251	6,392	6,082	6,320	6,479	6,552
Other	1	1	1	1	1	1	1
Total trust intrafunds	23,234	6,252	6,393	6,083	6,321	6,480	6,553
Total intrafund transactions	52,459	35,940	40,297	42,831	45,935	49,180	52,687
Interfund transactions:							
Distributed by agency:							
Federal fund payments to trust funds:							
Contributions to insurance programs:							
Military retirement fund	17,928	22,462	23,180	23,973	24,813	25,676	26,565
Supplementary medical insurance	80,906	96,839	116,896	166,468	181,364	193,195	205,853
Proposed Legislation (non-PAYGO)	....	....	–118	–149	–147	–139	–149
Hospital insurance	8,946	8,423	9,667	10,573	11,567	13,218	14,497
Railroad social security equivalent fund	112	120	118	123	132	147	152
Rail industry pension fund	318	326	303	313	324	337	351
Civilian supplementary retirement contributions	22,139	26,222	26,629	26,832	27,037	27,440	27,944
Unemployment insurance	1,265	1,377	595	591	599	612	630
Other contributions	468	516	535	539	540	534	527
Proposed Legislation (PAYGO)	....	....	....	....	....	13	28
Subtotal	132,082	156,285	177,805	229,263	246,229	261,033	276,398
Miscellaneous payments	984	1,995	2,098	1,587	1,603	1,633	1,658
Proposed Legislation (non-PAYGO)	....	....	3,281	....	....	....	....
Subtotal	133,066	158,280	183,184	230,850	247,832	262,666	278,056
Trust fund payments to Federal funds:							
Other	1,113	1,183	1,263	1,328	2,701	3,202	3,269
Proposed Legislation (non-PAYGO)	....	....	2,764	–517	–512	–506	–507
Subtotal	1,113	1,183	4,027	811	2,189	2,696	2,762
Total interfunds distributed by agency	134,179	159,463	187,211	231,661	250,021	265,362	280,818
Undistributed by agency:							
Employer share, employee retirement (on-budget):							
Civil service retirement and disability insurance	11,288	11,566	12,769	13,768	14,927	16,191	17,509
CSRDI from Postal Service	3,331	4,364	4,450	4,514	4,577	4,640	4,703
Hospital insurance (contribution as employer) [1]	2,355	2,551	2,646	2,729	2,860	3,038	3,206
Proposed Legislation (non-PAYGO)	....	....	181	....	....	....	....
Postal employer contributions to FHI	694	706	730	751	774	800	828
Military retirement fund	13,720	14,794	13,299	13,572	14,046	14,446	14,871
Other Federal employees retirement	162	156	145	151	158	165	171
Total employer share, employee retirement (on-budget)	31,550	34,137	34,220	35,485	37,342	39,280	41,288

Table 17–5. OFFSETTING RECEIPTS BY TYPE—Continued

(In millions of dollars)

Source	2003 Actual	Estimate					
		2004	2005	2006	2007	2008	2009
Interest received by on-budget trust funds	72,523	67,388	68,912	71,475	74,437	77,967	82,089
Proposed Legislation (non-PAYGO)	....	....	3	17	18	26	20
Total interfund transactions undistributed by agency	104,073	101,525	103,135	106,977	111,797	117,273	123,397
Total interfund transactions	238,252	260,988	290,346	338,638	361,818	382,635	404,215
Total on-budget receipts	290,711	296,928	330,643	381,469	407,753	431,815	456,902
Off-budget receipts:							
Trust intrafund transactions:							
Distributed by agency:							
Interfund transactions:							
Distributed by agency:							
Federal fund payments to trust funds:							
Old-age, survivors, and disability insurance	13,277	14,298	15,124	16,424	17,927	20,508	21,459
Undistributed by agency:							
Employer share, employee retirement (off-budget)	9,602	10,654	11,199	11,771	12,510	13,474	14,410
Proposed Legislation (non-PAYGO)	....	....	759	....	....	....	....
Interest received by off-budget trust funds	83,544	86,286	91,918	100,124	110,171	122,419	136,640
Total off-budget receipts:	106,423	111,238	119,000	128,319	140,608	156,401	172,509
Total intragovernmental transactions	**397,134**	**408,166**	**449,643**	**509,788**	**548,361**	**588,216**	**629,411**
PROPRIETARY RECEIPTS FROM THE PUBLIC							
Distributed by agency:							
Interest:							
Interest on foreign loans and deferred foreign collections	465	459	451	434	458	373	371
Interest on deposits in tax and loan accounts	130	221	464	540	622	715	822
Other interest (domestic—civil) [2]	10,934	11,538	11,839	12,311	13,094	14,010	14,834
Total interest	11,529	12,218	12,754	13,285	14,174	15,098	16,027
Dividends and other earnings	2,489	1,895	1,111	1,189	1,225	1,241	1,235
Royalties and rents	2,121	2,336	2,420	2,465	2,433	2,470	2,494
Proposed Legislation (PAYGO)	....	....	8	8	8	8	8
Sale of products:							
Sale of timber and other natural land products	198	429	446	447	471	507	494
Sale of minerals and mineral products	31	35	38	42	46	46	48
Sale of power and other utilities	686	691	726	822	826	826	846
Proposed Legislation (non-PAYGO)	....	....	–180	–186	–191	–197	–204
Other	92	75	86	82	72	89	85
Total sale of products	1,007	1,230	1,116	1,207	1,224	1,271	1,269
Fees and other charges for services and special benefits:							
Medicare premiums and other charges (trust funds)	28,433	32,169	36,839	49,297	55,128	58,926	62,969
Proposed Legislation (non-PAYGO)	....	....	–36	–50	–49	–51	–51
Nuclear waste disposal revenues	726	740	749	754	757	767	767
Proposed Legislation (PAYGO)	....	....	–749	–754	–757	–767	–767
Veterans life insurance (trust funds)	176	166	156	144	131	118	107
Other [2]	4,120	4,263	4,880	11,325	14,109	14,893	15,712
Proposed Legislation (PAYGO)	....	....	7	82	105	104	109
Total fees and other charges	33,455	37,338	41,846	60,798	69,424	73,990	78,846
Sale of Government property:							
Sale of land and other real property [2]	320	495	1,063	362	390	417	295
Proposed Legislation (PAYGO)	....	....	24	33	38	48	48
Military assistance program sales (trust funds)	10,454	11,974	10,882	10,849	11,044	11,243	11,446
Other	112	122	116	86	38	26	25
Total sale of Government property	10,886	12,591	12,085	11,330	11,510	11,734	11,814
Realization upon loans and investments:							
Negative subsidies and downward reestimates	9,842	8,399	937	891	882	866	853
Repayment of loans to foreign nations	85	88	94	108	25	28	30

Table 17–5. OFFSETTING RECEIPTS BY TYPE—Continued

(In millions of dollars)

Source	2003 Actual	Estimate					
		2004	2005	2006	2007	2008	2009
Other	95	88	84	80	78	74	74
Total realization upon loans and investments	10,022	8,575	1,115	1,079	985	968	957
Recoveries and refunds [2]	3,487	4,552	4,822	4,705	4,291	3,702	3,812
Proposed Legislation (PAYGO)	....	....	15	–48	–134	–118	–122
Miscellaneous receipt accounts [2]	1,631	2,241	2,277	2,316	2,338	2,367	2,394
Total proprietary receipts from the public distributed by agency	76,627	82,976	79,569	98,334	107,478	112,731	118,734
Undistributed by agency:							
Rents, bonuses, and royalties:							
Outer Continental Shelf rents and bonuses	1,292	620	527	564	557	588	545
Outer Continental Shelf royalties	3,737	3,967	4,228	5,043	5,056	5,128	5,148
Arctic National Wildlife Refuge:							
Proposed Legislation (PAYGO)	....	....	....	2,402	2	202	2
Sale of major assets	....	....	....	323	....	....	....
Total proprietary receipts from the public undistributed by agency	5,029	4,587	4,755	8,332	5,615	5,918	5,695
Total proprietary receipts from the public	**81,656**	**87,563**	**84,324**	**106,666**	**113,093**	**118,649**	**124,429**
OFFSETTING GOVERNMENTAL RECEIPTS							
Distributed by agency:							
Defense cooperation	....	16	12	12	12	12	12
Regulatory fees	4,231	4,469	4,144	3,572	3,565	3,623	3,678
Proposed Legislation (non-PAYGO)	....	....	–44	–44	–45	–47	–47
Proposed Legislation (PAYGO)	....	....	843	1,414	1,471	1,530	1,593
Other	49	52	53	52	55	56	57
Undistributed by agency:							
Spectrum auction proceeds	....	....	100	9,000	11,200	4,200	15
Proposed Legislation (PAYGO)	....	....	....	50	–1,350	–1,200	3,580
Total offsetting governmental receipts	4,280	4,537	5,108	14,056	14,908	8,174	8,888
Total offsetting receipts	**483,070**	**500,266**	**539,075**	**630,510**	**676,362**	**715,039**	**762,728**

[1] Includes provision for covered Federal civilian employees and military personnel.

[2] Includes both Federal funds and trust funds.

18. TAX EXPENDITURES

The Congressional Budget Act of 1974 (Public Law 93–344) requires that a list of "tax expenditures" be included in the budget. Tax expenditures are defined in the law as "revenue losses attributable to provisions of the Federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of liability." These exceptions may be viewed as alternatives to other policy instruments, such as spending or regulatory programs. Identification and measurement of tax expenditures depends importantly on the baseline tax system against which the actual tax system is compared.

The largest reported tax expenditures tend to be associated with the individual income tax. For example, sizeable deferrals, deductions and exclusions are provided for pension contributions and earnings, employer contributions for medical insurance, capital gains, and payments of State and local individual income and property taxes. Reported tax expenditures under the corporate income tax tend to be related to timing differences in the rate of cost recovery for various investments. As is discussed below, the extent to which these provisions are classified as tax expenditures varies according to the conceptual baseline used.

Each tax expenditure estimate in this chapter was calculated assuming other parts of the tax code remained unchanged. The estimates would be different if all tax expenditures or major groups of tax expenditures were changed simultaneously because of potential interactions among provisions. For that reason, this chapter does not present a grand total for the estimated tax expenditures. Moreover, past tax changes entailing broad elimination of tax expenditures were generally accompanied by changes in tax rates or other basic provisions, so that the net effects on Federal revenues were considerably (if not totally) offset.

Tax expenditures relating to the individual and corporate income taxes are estimated for fiscal years 2003–2009 using three methods of accounting: revenue effects, outlay equivalent, and present value. The present value approach provides estimates of the revenue effects for tax expenditures that generally involve deferrals of tax payments into the future.

The section of the chapter on performance measures and economic effects presents information related to assessment of the effect of tax expenditures on the achievement of program performance goals. This section is a complement to the Government-wide performance plan required by the Government Performance and Results Act of 1993.

The 2004 Budget included a thorough review of important ambiguities in the tax expenditure concept. In particular, this review focused on defining tax expenditures relative to a comprehensive income tax baseline, defining tax expenditures relative to a broad-based consumption tax baseline, and defining negative tax expenditures, i.e., provisions of current law that overtax certain items or activities. This review has been updated and is presented in the Appendix.

TAX EXPENDITURES IN THE INCOME TAX

Tax Expenditure Estimates

All tax expenditure estimates presented here are based upon current tax law enacted as of December 31, 2003. Expired or repealed provisions are not listed if their revenue effects result only from taxpayer activity occurring before fiscal year 2003. Due to the time required to estimate the large number of tax expenditures, the estimates are based on Mid-Session economic assumptions; exceptions are the earned income tax credit and child credit provisions, which involve outlay components and hence are updated to reflect the economic assumptions used elsewhere in the budget.

The total revenue effects for tax expenditures for fiscal years 2003–2009 are displayed according to the budget's functional categories in Table 18–1. Descriptions of the specific tax expenditure provisions follow the tables of estimates and the discussion of general features of the tax expenditure concept.

As in prior years, two baseline concepts—the normal tax baseline and the reference tax law baseline—are used to identify tax expenditures. These baseline concepts are thoroughly discussed in Special Analysis G of the 1985 Budget, where the former is referred to as the pre-1983 method, and the latter the post-1982 method. For the most part, the two concepts coincide. However, items treated as tax expenditures under the normal tax baseline, but not the reference tax law baseline, are indicated by the designation "normal tax method" in the tables. The revenue effects for these items are zero using the reference tax rules. The alternative baseline concepts are discussed in detail following the tables.

Table 18–2 reports the respective portions of the total revenue effects that arise under the individual and corporate income taxes separately. The location of the estimates under the individual and corporate headings does not imply that these categories of filers benefit from the special tax provisions in proportion to the respective tax expenditure amounts shown. Rather, these breakdowns show the specific tax accounts through which the various provisions are cleared. The ultimate beneficiaries of corporate tax expenditures could be shareholders, employees, customers, or other providers of capital, depending on economic forces.

Table 18–3 ranks the major tax expenditures by the size of their FY 2005–2009 revenue effect.

Interpreting Tax Expenditure Estimates

The estimates shown for individual tax expenditures in Tables 18–1, 18–2, and 18–3 do not necessarily equal the increase in Federal revenues (or the change in the budget balance) that would result from repealing these special provisions, for the following reasons:

Eliminating a tax expenditure may have incentive effects that alter economic behavior. These incentives can affect the resulting magnitudes of the activity or of other tax provisions or Government programs. For example, if capital gains were taxed at ordinary rates, capital gain realizations would be expected to decline, potentially resulting in a decline in tax receipts. Such behavioral effects are not reflected in the estimates.

Tax expenditures are interdependent even without incentive effects. Repeal of a tax expenditure provision can increase or decrease the tax revenues associated with other provisions. For example, even if behavior does not change, repeal of an itemized deduction could increase the revenue costs from other deductions because some taxpayers would be moved into higher tax brackets. Alternatively, repeal of an itemized deduction could lower the revenue cost from other deductions if taxpayers are led to claim the standard deduction instead of itemizing. Similarly, if two provisions were repealed simultaneously, the increase in tax liability could be greater or less than the sum of the two separate tax expenditures, because each is estimated assuming that the other remains in force. In addition, the estimates reported in Table 18–1 are the totals of individual and corporate income tax revenue effects reported in Table 18–2 and do not reflect any possible interactions between the individual and corporate income tax receipts. For this reason, the estimates in Table 18–1 (as well as those in Table 18–5, which are also based on summing individual and corporate estimates) should be regarded as approximations.

Present-Value Estimates

The annual value of tax expenditures for tax deferrals is reported on a cash basis in all tables except Table 18–4. Cash-based estimates reflect the difference between taxes deferred in the current year and incoming revenues that are received due to deferrals of taxes from prior years. Although such estimates are useful as a measure of cash flows into the Government, they do not accurately reflect the true economic cost of these provisions. For example, for a provision where activity levels have changed, so that incoming tax receipts from past deferrals are greater than deferred receipts from new activity, the cash-basis tax expenditure estimate can be negative, despite the fact that in present-value terms current deferrals do have a real cost to the Government. Alternatively, in the case of a newly enacted deferral provision, a cash-based estimate can overstate the real effect on receipts to the Government because the newly deferred taxes will ultimately be received. Present-value estimates, which are a useful complement to the cash-basis estimates for provisions involving deferrals, are discussed below.

Discounted present-value estimates of revenue effects are presented in Table 18–4 for certain provisions that involve tax deferrals or other long-term revenue effects. These estimates complement the cash-based tax expenditure estimates presented in the other tables.

The present-value estimates represent the revenue effects, net of future tax payments, that follow from activities undertaken during calendar year 2003 which cause the deferrals or other long-term revenue effects. For instance, a pension contribution in 2003 would cause a deferral of tax payments on wages in 2003 and on pension earnings on this contribution (e.g., interest) in later years. In some future year, however, the 2003 pension contribution and accrued earnings will be paid out and taxes will be due; these receipts are included in the present-value estimate. In general, this conceptual approach is similar to the one used for reporting the budgetary effects of credit programs, where direct loans and guarantees in a given year affect future cash flows.

Table 18–1. ESTIMATES OF TOTAL INCOME TAX EXPENDITURES

(in millions of dollars)

		Total from corporations and individuals							
		2003	2004	2005	2006	2007	2008	2009	2005–09
	National Defense								
1	Exclusion of benefits and allowances to armed forces personnel	2,210	2,240	2,260	2,290	2,310	2,330	2,350	11,540
	International Affairs								
2	Exclusion of income earned abroad by U.S. citizens	2,620	2,680	2,750	2,810	2,940	3,100	3,270	14,870
3	Exclusion of certain allowances for Federal employees abroad	770	800	840	880	920	960	1,010	4,610
4	Extraterritorial income exclusion	5,150	5,510	5,890	6,290	6,730	7,200	7,700	33,810
5	Inventory property sales source rules exception	1,540	1,620	1,700	1,790	1,880	1,980	2,080	9,430
6	Deferral of income from controlled foreign corporations (normal tax method)	7,450	7,900	8,400	8,930	9,550	10,210	10,920	48,010
7	Deferred taxes for financial firms on certain income earned overseas	2,050	2,130	2,190	2,260	960	....	....	5,410
	General Science, Space, and Technology								
8	Expensing of research and experimentation expenditures (normal tax method)	–1,980	–2,350	4,500	8,290	7,110	6,360	5,570	31,830
9	Credit for increasing research activities	4,960	4,400	2,550	1,090	460	150	60	4,310
	Energy								
10	Expensing of exploration and development costs, fuels	210	270	170	80	70	60	40	420
11	Excess of percentage over cost depletion, fuels	640	620	580	590	610	610	610	3,000
12	Alternative fuel production credit	1,280	890	890	890	890	350	....	3,020
13	Exception from passive loss limitation for working interests in oil and gas properties	20	20	20	20	20	20	20	100
14	Capital gains treatment of royalties on coal	100	110	120	120	130	130	140	640
15	Exclusion of interest on energy facility bonds	90	100	110	110	120	130	130	600
16	Enhanced oil recovery credit	400	400	410	420	430	440	450	2,150
17	New technology credit	280	350	370	370	370	370	370	1,850
18	Alcohol fuel credits [1]	30	30	30	30	30	30	30	150
19	Tax credit and deduction for clean-fuel burning vehicles	70	60	10	–20	–70	–60	–70	–210
20	Exclusion from income of conservation subsidies provided by public utilities	80	80	80	80	80	80	80	400
	Natural Resources and Environment								
21	Expensing of exploration and development costs, nonfuel minerals	10	10	10	10	10	10	10	50
22	Excess of percentage over cost depletion, nonfuel minerals	250	250	260	260	270	280	280	1,350
23	Exclusion of interest on bonds for water, sewage, and hazardous waste facilities	450	490	530	570	590	630	650	2,970
24	Capital gains treatment of certain timber income	100	110	120	120	130	130	140	640
25	Expensing of multiperiod timber growing costs	340	340	350	370	380	400	410	1,910
26	Tax incentives for preservation of historic structures	270	290	300	320	330	340	370	1,660
	Agriculture								
27	Expensing of certain capital outlays	120	130	130	130	140	150	160	710
28	Expensing of certain multiperiod production costs	90	90	90	100	100	100	100	490
29	Treatment of loans forgiven for solvent farmers	10	10	10	10	10	10	10	50
30	Capital gains treatment of certain income	1,050	1,100	1,160	1,220	1,280	1,350	1,420	6,430
31	Income averaging for farmers	70	80	80	80	80	90	90	420
32	Deferral of gain on sale of farm refiners	10	10	10	10	20	20	20	80
	Commerce and Housing								
	Financial institutions and insurance:								
33	Exemption of credit union income	1,300	1,360	1,430	1,500	1,570	1,650	1,730	7,880
34	Excess bad debt reserves of financial institutions	40	30	20	20	10	....	....	50
35	Exclusion of interest on life insurance savings	18,900	20,500	22,130	24,010	26,050	28,260	30,660	131,110
36	Special alternative tax on small property and casualty insurance companies	120	120	130	130	140	140	140	680
37	Tax exemption of certain insurance companies owned by tax-exempt organizations	190	210	220	240	250	260	280	1,250
38	Small life insurance company deduction	90	90	90	90	90	90	90	450
	Housing:								
39	Exclusion of interest on owner-occupied mortgage subsidy bonds	910	990	1,080	1,150	1,200	1,280	1,320	6,030
40	Exclusion of interest on rental housing bonds	280	310	350	370	380	400	410	1,910
41	Deductibility of mortgage interest on owner-occupied homes	61,160	62,590	69,740	74,800	78,420	83,030	87,920	393,910
42	Deductibility of State and local property tax on owner-occupied homes	22,090	21,740	19,410	16,110	14,580	13,640	13,110	76,850
43	Deferral of income from post 1987 installment sales	1,080	1,100	1,120	1,140	1,160	1,190	1,200	5,810
44	Capital gains exclusion on home sales	20,260	20,860	21,490	22,140	22,800	23,480	24,190	114,100
45	Exception from passive loss rules for $25,000 of rental loss	5,710	4,570	4,390	4,210	4,020	3,840	3,660	20,120
46	Credit for low-income housing investments	6,210	6,550	6,860	7,180	7,470	7,830	8,210	37,550
47	Accelerated depreciation on rental housing (normal tax method)	1,220	620	–170	–1,110	–2,330	–3,560	–4,900	–12,070
	Commerce:								
48	Cancellation of indebtedness	20	30	30	30	40	40	40	180
49	Exceptions from imputed interest rules	50	50	50	50	50	50	50	250
50	Capital gains (except agriculture, timber, iron ore, and coal) [2]	25,730	27,300	30,190	32,930	36,410	48,930	29,210	177,670
51	Capital gains exclusion of small corporation stock	130	160	210	250	300	350	390	1,500
52	Step-up basis of capital gains at death	14,880	16,280	18,240	20,240	22,240	24,190	26,010	110,920
53	Carryover basis of capital gains on gifts	590	390	450	540	550	580	620	2,740
54	Ordinary income treatment of loss from small business corporation stock sale	40	50	50	50	50	50	50	250
55	Accelerated depreciation of buildings other than rental housing (normal tax method)	–2,290	–3,190	–4,060	–4,690	–6,810	–10,170	–14,430	–40,160

Table 18–1. ESTIMATES OF TOTAL INCOME TAX EXPENDITURES—Continued

(in millions of dollars)

		Total from corporations and individuals							
		2003	2004	2005	2006	2007	2008	2009	2005–09
56	Accelerated depreciation of machinery and equipment (normal tax method)	48,520	46,800	–10,920	–37,940	–31,040	–28,770	–27,590	–136,260
57	Expensing of certain small investments (normal tax method)	1,030	1,590	4,850	1,650	–490	–30	130	6,110
58	Amortization of start-up costs (normal tax method)	110	120	130	150	160	160	160	760
59	Graduated corporation income tax rate (normal tax method)	3,030	3,090	3,910	4,650	4,800	4,890	5,040	23,290
60	Exclusion of interest on small issue bonds	390	430	470	490	520	550	570	2,600
	Transportation								
61	Deferral of tax on shipping companies	20	20	20	20	20	20	20	100
62	Exclusion of reimbursed employee parking expenses	2,130	2,240	2,360	2,490	2,610	2,740	2,880	13,080
63	Exclusion for employer-provided transit passes	320	380	450	520	590	660	730	2,950
	Community and Regional Development								
64	Investment credit for rehabilitation of structures (other than historic)	30	30	30	30	30	30	30	150
65	Exclusion of interest for airport, dock, and similar bonds	770	840	910	970	1,020	1,080	1,110	5,090
66	Exemption of certain mutuals' and cooperatives' income	60	60	70	70	70	70	70	350
67	Empowerment zones, Enterprise communities, and Renewal communities	1,070	1,080	1,120	1,210	1,320	1,470	1,730	6,850
68	New markets tax credit	190	290	430	610	830	870	790	3,530
69	Expensing of environmental remediation costs	80	20	–10	–10	–10	–10	–10	–50
	Education, Training, Employment, and Social Services								
	Education:								
70	Exclusion of scholarship and fellowship income (normal tax method)	1,260	1,260	1,340	1,400	1,410	1,420	1,420	6,990
71	HOPE tax credit	3,290	3,420	3,510	3,290	3,330	3,320	3,310	16,760
72	Lifetime Learning tax credit	1,910	2,250	2,180	2,120	2,320	2,320	2,300	11,240
73	Education Individual Retirement Accounts	70	110	140	190	240	300	370	1,240
74	Deductibility of student-loan interest	730	760	780	800	820	830	840	4,070
75	Deduction for higher education expenses	1,730	1,810	2,580	2,610	....	....	....	5,190
76	State prepaid tuition plans	50	150	320	430	510	590	660	2,510
77	Exclusion of interest on student-loan bonds	260	280	310	320	340	360	380	1,710
78	Exclusion of interest on bonds for private nonprofit educational facilities	780	850	930	990	1,030	1,100	1,130	5,180
79	Credit for holders of zone academy bonds	80	90	110	130	130	140	140	650
80	Exclusion of interest on savings bonds redeemed to finance educational expenses	10	10	10	10	20	20	20	80
81	Parental personal exemption for students age 19 or over	3,140	3,130	2,550	2,000	1,760	1,580	1,430	9,320
82	Deductibility of charitable contributions (education)	3,670	3,390	3,660	4,000	4,230	4,510	4,830	21,230
83	Exclusion of employer-provided educational assistance	500	530	560	590	620	660	690	3,120
84	Special deduction for teacher expenses	140	140	....	....	....	....	....	....
	Training, employment, and social services:								
85	Work opportunity tax credit	430	370	170	70	30	....	....	270
86	Welfare-to-work tax credit	60	60	40	30	20	....	....	90
87	Employer provided child care exclusion	590	620	770	870	920	960	1,010	4,530
88	Employer-provided child care credit	90	130	140	150	160	170	180	800
89	Assistance for adopted foster children	250	290	330	380	430	480	540	2,160
90	Adoption credit and exclusion	220	450	500	540	560	570	580	2,750
91	Exclusion of employee meals and lodging (other than military)	780	810	850	890	930	970	1,000	4,640
92	Child credit [3]	37,970	24,340	29,860	24,810	24,680	24,480	25,430	129,260
93	Credit for child and dependent care expenses	2,720	2,950	2,690	2,210	2,030	1,900	1,780	10,610
94	Credit for disabled access expenditures	50	50	60	60	60	60	60	300
95	Deductibility of charitable contributions, other than education and health	30,020	27,370	29,670	32,550	34,500	36,790	39,410	172,920
96	Exclusion of certain foster care payments	430	430	440	450	460	470	570	2,390
97	Exclusion of parsonage allowances	380	400	420	450	480	510	540	2,400
	Health								
98	Exclusion of employer contributions for medical insurance premiums and medical care	101,920	106,720	112,990	120,940	129,820	139,620	150,300	653,670
99	Deductibility of self-employed medical insurance premiums	2,550	3,740	3,780	4,090	4,370	4,750	5,150	22,140
100	Medical Savings Accounts/Health Savings Accounts	–30	–140	–570	–960	–1,380	–1,920	–2,180	–7,010
101	Deductibility of medical expenses	6,240	6,880	7,900	8,480	9,180	10,200	10,990	46,750
102	Exclusion of interest on hospital construction bonds	1,620	1,780	1,930	2,060	2,160	2,290	2,360	10,800
103	Deductibility of charitable contributions (health)	3,390	3,090	3,350	3,670	3,890	4,150	4,450	19,510
104	Tax credit for orphan drug research	160	180	200	220	250	280	310	1,260
105	Special Blue Cross/Blue Shield deduction	350	320	310	280	310	260	290	1,450
106	Tax credit for health insurance purchased by certain displaced and retired individuals [4]	....	50	60	60	70	70	80	340
	Income Security								
107	Exclusion of railroad retirement system benefits	400	400	400	400	400	400	400	2,000
108	Exclusion of workers' compensation benefits	6,100	6,460	6,850	7,270	7,710	8,190	8,690	38,710
109	Exclusion of public assistance benefits (normal tax method)	400	410	430	450	470	490	510	2,350
110	Exclusion of special benefits for disabled coal miners	60	60	50	50	50	40	40	230
111	Exclusion of military disability pensions	100	110	110	110	110	120	120	570
	Net exclusion of pension contributions and earnings:.								
112	Employer plans	59,480	59,380	61,740	66,340	62,650	58,360	60,440	309,530

Table 18–1. ESTIMATES OF TOTAL INCOME TAX EXPENDITURES—Continued

(in millions of dollars)

		Total from corporations and individuals							
		2003	2004	2005	2006	2007	2008	2009	2005–09
113	401(k) plans	51,560	56,740	58,910	61,340	65,750	71,080	75,440	332,520
114	Individual Retirement Accounts	20,060	19,810	20,090	20,610	20,150	19,710	19,490	100,050
115	Low and moderate income savers credit	880	960	1,100	1,210	730	....	....	3,040
116	Keogh plans	6,020	8,730	9,260	9,860	10,530	11,480	12,500	53,630
	Exclusion of other employee benefits:								
117	Premiums on group term life insurance	1,800	1,830	1,860	1,890	1,920	1,950	1,990	9,610
118	Premiums on accident and disability insurance	230	240	250	260	270	280	290	1,350
119	Small business retirement plan credit	40	80	100	130	140	150	150	670
120	Income of trusts to finance supplementary unemployment benefits	30	30	30	30	30	30	30	....
121	Special ESOP rules	1,780	1,920	2,060	2,220	2,400	2,580	2,780	12,040
122	Additional deduction for the blind	40	30	40	40	40	40	40	200
123	Additional deduction for the elderly	1,840	1,710	1,800	1,900	1,960	1,920	1,940	9,520
124	Tax credit for the elderly and disabled	20	10	10	10	10	10	10	50
125	Deductibility of casualty losses	500	690	670	680	640	600	630	3,220
126	Earned income tax credit [5]	5,099	4,884	5,006	5,477	5,515	5,603	5,780	27,381
	Social Security								
	Exclusion of social security benefits:								
127	Social Security benefits for retired workers	18,600	19,620	19,040	19,370	20,390	19,710	19,910	98,420
128	Social Security benefits for disabled	3,230	3,570	3,720	3,840	4,080	4,280	4,500	20,420
129	Social Security benefits for dependents and survivors	4,060	4,380	4,310	4,160	4,190	4,030	4,040	20,730
	Veterans Benefits and Services								
130	Exclusion of veterans death benefits and disability compensation	3,320	3,330	3,600	3,930	4,170	4,300	4,560	20,560
131	Exclusion of veterans pensions	100	100	100	110	110	110	120	550
132	Exclusion of GI bill benefits	110	120	130	130	160	170	170	760
133	Exclusion of interest on veterans housing bonds	40	50	50	50	60	60	60	280
	General Purpose Fiscal Assistance								
134	Exclusion of interest on public purpose State and local bonds	25,480	25,980	26,370	26,440	26,150	26,940	27,750	133,650
135	Deductibility of nonbusiness State and local taxes other than on owner-occupied homes	49,770	49,470	46,180	39,100	35,930	34,710	34,370	190,290
136	Tax credit for corporations receiving income from doing business in U.S. possessions	1,200	1,150	1,100	800	....	....	....	1,900
	Interest								
137	Deferral of interest on U.S. savings bonds	30	40	40	40	40	40	50	210
	Addendum: Aid to State and local governments:								
	Deductibility of:								
	Property taxes on owner-occupied homes	22,090	21,740	19,410	16,110	14,580	13,640	13,110	76,850
	Nonbusiness State and local taxes other than on owner-occupied homes	49,770	49,470	46,180	39,100	35,930	34,710	34,370	190,290
	Exclusion of interest on State and local bonds for:								
	Public purposes	25,480	25,980	26,370	26,440	26,150	26,940	27,750	133,650
	Energy facilities	90	100	110	110	120	130	130	600
	Water, sewage, and hazardous waste disposal facilities	450	490	530	570	590	630	650	2,970
	Small-issues	390	430	470	490	520	550	570	2,600
	Owner-occupied mortgage subsidies	910	990	1,080	1,150	1,200	1,280	1,320	6,030
	Rental housing	280	310	350	370	380	400	410	1,910
	Airports, docks, and similar facilities	770	840	910	970	1,020	1,080	1,110	5,090
	Student loans	260	280	310	320	340	360	380	1,710
	Private nonprofit educational facilities	780	850	930	990	1,030	1,100	1,130	5,180
	Hospital construction	1,620	1,780	1,930	2,060	2,160	2,290	2,360	10,800
	Veterans' housing	40	50	50	50	60	60	60	280
	Credit for holders of zone academy bonds	80	90	110	130	130	140	140	650

[1] In addition, the partial exemption from the excise tax for alcohol fuels results in a reduction in excise tax receipts (in millions of dollars) as follows: 2003 $1,100; 2004 $1,260; 2005 $1,370; 2006 $1,430; 2007 $1,470; 2008 $1,510; and 2009 $1,550.

[2] If corporate equity were to be included, the revenue loss estimates would be $48,540 in 2003, $51,510 in 2004, $56,970 in 2005, $62,140 in 2006, $68,690 in 2007, $92,320 in 2008, and $55,110 in 2009. Similarly, if the reduced tax rate on dividends were to be included, the revenue loss estimates would be $1,810 in 2003, $16,720 in 2004, $13,280 in 2005, $13,880 in 2006, $14,480 in 2007, $15,970 in 2008, and $8,540 in 2009.

[3] The figures in the table indicate the effect of the child tax credit on receipts. The effect of the credit on outlays (in millions of dollars) is as follows: 2003 $6,435; 2004 $7,447; 2005 $11,486; 2006 $8,440; 2007 $8,237; 2008 $7,956; and 2009 $7,909

[4] In addition to the receipts shown outlays of $60 million in 2004, $90 million in 2005, $100 million in 2006, $120 million in 2007, $130 million in 2008, and $140 million in 2009 are projected.

[5] The figures in the table indicate the effect of the earned income tax credit on receipts. The effect of the credit on outlays (in millions of dollars) is as follows: 2003 $31,961; 2004 $33,551; 2005 $34,148; 2006 $34,488; 2007 $34,338; 2008 $34,359; and 2009 $35,161.

Note: Provisions with estimates denoted normal tax method have no revenue loss under the reference tax law method.

All estimates have been rounded to the nearest $10 million. Provisions with estimates that rounded to zero in each year are not included in the table.

Table 18–2. ESTIMATES OF TAX EXPENDITURES FOR THE CORPORATE AND INDIVIDUAL INCOME TAXES

(in millions of dollars)

		Corporations								Individuals							
		2003	2004	2005	2006	2007	2008	2009	2005–09	2003	2004	2005	2006	2007	2008	2009	2005–09
	National Defense																
1	Exclusion of benefits and allowances to armed forces personnel	....	....	....	....	....	....	....	....	2,210	2,240	2,260	2,290	2,310	2,330	2,350	11,540
	International Affairs																
2	Exclusion of income earned abroad by U.S. citizens	....	....	....	....	....	....	....	....	2,620	2,680	2,750	2,810	2,940	3,100	3,270	14,870
3	Exclusion of certain allowances for Federal employees abroad	....	....	....	....	....	....	....	....	770	800	840	880	920	960	1,010	4,610
4	Extraterritorial income exclusion	5,150	5,510	5,890	6,290	6,730	7,200	7,700	33,810	....	....	....	....	....	....	....	....
5	Inventory property sales source rules exception	1,540	1,620	1,700	1,790	1,880	1,980	2,080	9,430	....	....	....	....	....	....	....	....
6	Deferral of income from controlled foreign corporations (normal tax method)	7,450	7,900	8,400	8,930	9,550	10,210	10,920	48,010	....	....	....	....	....	....	....	....
7	Deferred taxes for financial firms on certain income earned overseas	2,050	2,130	2,190	2,260	960	....	....	5,410	....	....	....	....	....	....	....	....
	General Science, Space, and Technology																
8	Expensing of research and experimentation expenditures (normal tax method)	–1,940	–2,300	4,400	8,130	6,970	6,240	5,460	31,200	–40	–50	100	160	140	120	110	630
9	Credit for increasing research activities	4,910	4,360	2,530	1,090	460	150	60	4,290	50	40	20	....	....	....	....	20
	Energy																
10	Expensing of exploration and development costs, fuels	180	240	150	70	60	50	30	360	30	30	20	10	10	10	10	60
11	Excess of percentage over cost depletion, fuels	530	510	480	490	510	510	510	2,500	110	110	100	100	100	100	100	500
12	Alternative fuel production credit	1,230	850	850	850	850	340	....	2,890	50	40	40	40	40	10	....	130
13	Exception from passive loss limitation for working interests in oil and gas properties	....	....	....	....	....	....	....	....	20	20	20	20	20	20	20	100
14	Capital gains treatment of royalties on coal	....	....	....	....	....	....	....	....	100	110	120	120	130	130	140	640
15	Exclusion of interest on energy facility bonds	20	20	20	20	20	20	20	100	70	80	90	90	100	110	110	500
16	Enhanced oil recovery credit	360	360	370	380	390	400	410	1,950	40	40	40	40	40	40	40	200
17	New technology credit	280	350	370	370	370	370	370	1,850	....	....	....	....	....	....	....	....
18	Alcohol fuel credits [1]	20	20	20	20	20	20	20	100	10	10	10	10	10	10	10	50
19	Tax credit and deduction for clean-fuel burning vehicles	50	40	10	–20	–60	–50	–60	–180	20	20	....	....	–10	–10	–10	–30
20	Exclusion from income of conservation subsidies provided by public utilities	....	....	....	....	....	....	....	....	80	80	80	80	80	80	80	400
	Natural Resources and Environment																
21	Expensing of exploration and development costs, nonfuel minerals	10	10	10	10	10	10	10	50	....	....	....	....	....	....	....	....
22	Excess of percentage over cost depletion, nonfuel minerals	230	230	240	240	250	260	260	1,250	20	20	20	20	20	20	20	100
23	Exclusion of interest on bonds for water, sewage, and hazardous waste facilities	100	100	100	110	110	110	120	550	350	390	430	460	480	520	530	2,420
24	Capital gains treatment of certain timber income	....	....	....	....	....	....	....	....	100	110	120	120	130	130	140	640
25	Expensing of multiperiod timber growing costs	230	230	240	250	260	280	290	1,320	110	110	110	120	120	120	120	590
26	Tax incentives for preservation of historic structures	210	230	240	250	260	270	290	1,310	60	60	60	70	70	70	80	350
	Agriculture																
27	Expensing of certain capital outlays	20	20	20	20	20	30	30	120	100	110	110	110	120	120	130	590
28	Expensing of certain multiperiod production costs	20	20	20	20	20	20	20	100	70	70	70	80	80	80	80	390
29	Treatment of loans forgiven for solvent farmers	....	....	....	....	....	....	....	....	10	10	10	10	10	10	10	50
30	Capital gains treatment of certain income	....	....	....	....	....	....	....	....	1,050	1,100	1,160	1,220	1,280	1,350	1,420	6,430
31	Income averaging for farmers	....	....	....	....	....	....	....	....	70	80	80	80	80	90	90	420
32	Deferral of gain on sale of farm refiners	10	10	10	10	20	20	20	80	....	....	....	....	....	....	....	....
	Commerce and Housing																
	Financial institutions and insurance:																
33	Exemption of credit union income	1,300	1,360	1,430	1,500	1,570	1,650	1,730	7,880	....	....	....	....	....	....	....	....
34	Excess bad debt reserves of financial institutions	40	30	20	20	10	....	....	50	....	....	....	....	....	....	....	....
35	Exclusion of interest on life insurance savings	2,090	2,250	2,410	2,590	2,780	2,980	3,200	13,960	16,810	18,250	19,720	21,420	23,270	25,280	27,460	117,150
36	Special alternative tax on small property and casualty insurance companies	120	120	130	130	140	140	140	680	....	....	....	....	....	....	....	....
37	Tax exemption of certain insurance companies owned by tax-exempt organizations	190	210	220	240	250	260	280	1,250	....	....	....	....	....	....	....	....
38	Small life insurance company deduction	90	90	90	90	90	90	90	450	....	....	....	....	....	....	....	....
	Housing:																
39	Exclusion of interest on owner-occupied mortgage subsidy bonds	200	200	210	220	220	230	240	1,120	710	790	870	930	980	1,050	1,080	4,910
40	Exclusion of interest on rental housing bonds	60	60	70	70	70	70	70	350	220	250	280	300	310	330	340	1,560
41	Deductibility of mortgage interest on owner-occupied homes	....	....	....	....	....	....	....	....	61,160	62,590	69,740	74,800	78,420	83,030	87,920	393,910

Table 18–2. ESTIMATES OF TAX EXPENDITURES FOR THE CORPORATE AND INDIVIDUAL INCOME TAXES—Continued

(in millions of dollars)

		Corporations								Individuals							
		2003	2004	2005	2006	2007	2008	2009	2005–09	2003	2004	2005	2006	2007	2008	2009	2005–09
42	Deductibility of State and local property tax on owner-occupied homes	......	......	......	......	......	......	......	......	22,090	21,740	19,410	16,110	14,580	13,640	13,110	76,850
43	Deferral of income from post 1987 installment sales	280	290	290	300	300	310	310	1,510	800	810	830	840	860	880	890	4,300
44	Capital gains exclusion on home sales	......	......	......	......	......	......	......	......	20,260	20,860	21,490	22,140	22,800	23,480	24,190	114,100
45	Exception from passive loss rules for $25,000 of rental loss	......	......	......	......	......	......	......	......	5,710	4,570	4,390	4,210	4,020	3,840	3,660	20,120
46	Credit for low-income housing investments	3,450	3,640	3,810	3,990	4,150	4,350	4,560	20,860	2,760	2,910	3,050	3,190	3,320	3,480	3,650	16,690
47	Accelerated depreciation on rental housing (normal tax method)	50	–10	–50	–110	–180	–260	–340	–940	1,170	630	–120	–1,000	–2,150	–3,300	–4,560	–11,130
	Commerce:																
48	Cancellation of indebtedness	......	......	......	......	......	......	......	......	20	30	30	30	40	40	40	180
49	Exceptions from imputed interest rules	......	......	......	......	......	......	......	......	50	50	50	50	50	50	50	250
50	Capital gains (except agriculture, timber, iron ore, and coal)[2]	......	......	......	......	......	......	......	......	25,730	27,300	30,190	32,930	36,410	48,930	29,210	177,670
51	Capital gains exclusion of small corporation stock	......	......	......	......	......	......	......	......	130	160	210	250	300	350	390	1,500
52	Step-up basis of capital gains at death	......	......	......	......	......	......	......	......	14,880	16,280	18,240	20,240	22,240	24,190	26,010	110,920
53	Carryover basis of capital gains on gifts	......	......	......	......	......	......	......	......	590	390	450	540	550	580	620	2,740
54	Ordinary income treatment of loss from small business corporation stock sale	......	......	......	......	......	......	......	......	40	50	50	50	50	50	50	250
55	Accelerated depreciation of buildings other than rental housing (normal tax method)	–2,190	–2,920	–3,740	–4,250	–6,060	–9,050	–12,360	–35,460	–100	–270	–320	–440	–750	–1,120	–2,070	–4,700
56	Accelerated depreciation of machinery and equipment (normal tax method)	40,600	38,830	–8,720	–32,980	–26,580	–23,990	–22,400	–114,670	7,920	7,970	–2,200	–4,960	–4,460	–4,780	–5,190	–21,590
57	Expensing of certain small investments (normal tax method)	420	710	1,790	680	–390	–140	–30	1,910	610	880	3,060	970	–100	110	160	4,200
58	Amortization of start-up costs (normal tax method)	100	110	120	130	140	140	140	670	10	10	10	20	20	20	20	90
59	Graduated corporation income tax rate (normal tax method)	3,030	3,090	3,910	4,650	4,800	4,890	5,040	23,290	......	......	......	......	......	......	......	......
60	Exclusion of interest on small issue bonds	80	90	90	90	100	100	100	480	310	340	380	400	420	450	470	2,120
	Transportation																
61	Deferral of tax on shipping companies	20	20	20	20	20	20	20	100	......	......	......	......	......	......	......	......
62	Exclusion of reimbursed employee parking expenses	......	......	......	......	......	......	......	......	2,130	2,240	2,360	2,490	2,610	2,740	2,880	13,080
63	Exclusion for employer-provided transit passes	......	......	......	......	......	......	......	......	320	380	450	520	590	660	730	2,950
	Community and Regional Development																
64	Investment credit for rehabilitation of structures (other than historic)	20	20	20	20	20	20	20	100	10	10	10	10	10	10	10	50
65	Exclusion of interest for airport, dock, and similar bonds	170	170	180	180	190	190	200	940	600	670	730	790	830	890	910	4,150
66	Exemption of certain mutuals' and cooperatives' income	60	60	70	70	70	70	70	350	......	......	......	......	......	......	......	......
67	Empowerment zones, Enterprise communities, and Renewal communities	280	280	290	310	330	370	420	1,720	790	800	830	900	990	1,100	1,310	5,130
68	New markets tax credit	50	70	110	150	210	220	200	890	140	220	320	460	620	650	590	2,640
69	Expensing of environmental remediation costs	70	20	–10	–10	–10	–10	–10	–50	10	......	......	......	......	......	......	......
	Education, Training, Employment, and Social Services																
	Education:																
70	Exclusion of scholarship and fellowship income (normal tax method)	......	......	......	......	......	......	......	......	1,260	1,260	1,340	1,400	1,410	1,420	1,420	6,990
71	HOPE tax credit	......	......	......	......	......	......	......	......	3,290	3,420	3,510	3,290	3,330	3,320	3,310	16,760
72	Lifetime Learning tax credit	......	......	......	......	......	......	......	......	1,910	2,250	2,180	2,120	2,320	2,320	2,300	11,240
73	Education Individual Retirement Accounts	......	......	......	......	......	......	......	......	70	110	140	190	240	300	370	1,240
74	Deductibility of student-loan interest	......	......	......	......	......	......	......	......	730	760	780	800	820	830	840	4,070
75	Deduction for higher education expenses	......	......	......	......	......	......	......	......	1,730	1,810	2,580	2,610	......	......	......	5,190
76	State prepaid tuition plans	......	......	......	......	......	......	......	......	50	150	320	430	510	590	660	2,510
77	Exclusion of interest on student-loan bonds	60	60	60	60	60	60	70	310	200	220	250	260	280	300	310	1,400
78	Exclusion of interest on bonds for private nonprofit educational facilities ..	170	170	180	190	190	200	200	960	610	680	750	800	840	900	930	4,220
79	Credit for holders of zone academy bonds	80	90	110	130	130	140	140	650	......	......	......	......	......	......	......	......
80	Exclusion of interest on savings bonds redeemed to finance educational expenses	......	......	......	......	......	......	......	......	10	10	10	10	20	20	20	80
81	Parental personal exemption for students age 19 or over	......	......	......	......	......	......	......	......	3,140	3,130	2,550	2,000	1,760	1,580	1,430	9,320
82	Deductibility of charitable contributions (education)	490	510	540	560	590	620	660	2,970	3,180	2,880	3,120	3,440	3,640	3,890	4,170	18,260
83	Exclusion of employer-provided educational assistance	......	......	......	......	......	......	......	......	500	530	560	590	620	660	690	3,120
84	Special deduction for teacher expenses	......	......	......	......	......	......	......	......	140	140	......	......	......	......	......	......

Table 18–2. ESTIMATES OF TAX EXPENDITURES FOR THE CORPORATE AND INDIVIDUAL INCOME TAXES—Continued

(in millions of dollars)

		Corporations								Individuals							
		2003	2004	2005	2006	2007	2008	2009	2005–09	2003	2004	2005	2006	2007	2008	2009	2005–09
	Training, employment, and social services:																
85	Work opportunity tax credit	370	310	140	60	20	....	....	220	60	60	30	10	10	....	....	50
86	Welfare-to-work tax credit	50	50	30	20	10	....	....	60	10	10	10	10	10	....	....	30
87	Employer provided child care exclusion	....	....	....	....	....	....	....	....	590	620	770	870	920	960	1,010	4,530
88	Employer-provided child care credit	....	....	....	....	....	....	....	....	90	130	140	150	160	170	180	800
89	Assistance for adopted foster children	....	....	....	....	....	....	....	....	250	290	330	380	430	480	540	2,160
90	Adoption credit and exclusion	....	....	....	....	....	....	....	....	220	450	500	540	560	570	580	2,750
91	Exclusion of employee meals and lodging (other than military)	....	....	....	....	....	....	....	....	780	810	850	890	930	970	1,000	4,640
92	Child credit[3]	....	....	....	....	....	....	....	....	37,970	24,340	29,860	24,810	24,680	24,480	25,430	129,260
93	Credit for child and dependent care expenses	....	....	....	....	....	....	....	....	2,720	2,950	2,690	2,210	2,030	1,900	1,780	10,610
94	Credit for disabled access expenditures	10	10	20	20	20	20	20	100	40	40	40	40	40	40	40	200
95	Deductibility of charitable contributions, other than education and health	1,110	1,170	1,230	1,290	1,360	1,430	1,500	6,810	28,910	26,200	28,440	31,260	33,140	35,360	37,910	166,110
96	Exclusion of certain foster care payments	....	....	....	....	....	....	....	....	430	430	440	450	460	470	570	2,390
97	Exclusion of parsonage allowances	....	....	....	....	....	....	....	....	380	400	420	450	480	510	540	2,400
	Health																
98	Exclusion of employer contributions for medical insurance premiums and medical care	....	....	....	....	....	....	....	....	101,920	106,720	112,990	120,940	129,820	139,620	150,300	653,670
99	Deductibility of self-employed medical insurance premiums	....	....	....	....	....	....	....	....	2,550	3,740	3,780	4,090	4,370	4,750	5,150	22,140
100	Medical Savings Accounts/Health Savings Accounts	....	....	....	....	....	....	....	....	–30	–140	–570	–960	–1,380	–1,920	–2,180	–7,010
101	Deductibility of medical expenses	....	....	....	....	....	....	....	....	6,240	6,880	7,900	8,480	9,180	10,200	10,990	46,750
102	Exclusion of interest on hospital construction bonds	350	360	370	390	400	410	420	1,990	1,270	1,420	1,560	1,670	1,760	1,880	1,940	8,810
103	Deductibility of charitable contributions (health)	140	150	160	160	170	180	190	860	3,250	2,940	3,190	3,510	3,720	3,970	4,260	18,650
104	Tax credit for orphan drug research	160	180	200	220	250	280	310	1,260	....	....	....	....	....	....	....	....
105	Special Blue Cross/Blue Shield deduction	350	320	310	280	310	260	290	1,450	....	....	....	....	....	....	....	....
106	Tax credit for health insurance purchased by certain displaced and retired individuals[4]	....	....	....	....	....	....	....	....	....	50	60	60	70	70	80	340
	Income Security																
107	Exclusion of railroad retirement system benefits	....	....	....	....	....	....	....	....	400	400	400	400	400	400	400	2,000
108	Exclusion of workers' compensation benefits	....	....	....	....	....	....	....	....	6,100	6,460	6,850	7,270	7,710	8,190	8,690	38,710
109	Exclusion of public assistance benefits (normal tax method)	....	....	....	....	....	....	....	....	400	410	430	450	470	490	510	2,350
110	Exclusion of special benefits for disabled coal miners	....	....	....	....	....	....	....	....	60	60	50	50	50	40	40	230
111	Exclusion of military disability pensions	....	....	....	....	....	....	....	....	100	110	110	110	110	120	120	570
	Net exclusion of pension contributions and earnings:																
112	Employer plans	....	....	....	....	....	....	....	....	59,480	59,380	61,740	66,340	62,650	58,360	60,440	309,530
113	401(k) plans	....	....	....	....	....	....	....	....	51,560	56,740	58,910	61,340	65,750	71080	75440	332,520
114	Individual Retirement Accounts	....	....	....	....	....	....	....	....	20,060	19,810	20,090	20,610	20,150	19,710	19,490	100,050
115	Low and moderate income savers credit	....	....	....	....	....	....	....	....	880	960	1,100	1,210	730	....	....	3,040
116	Keogh plans	....	....	....	....	....	....	....	....	6,020	8,730	9,260	9,860	10,530	11,480	12,500	53,630
	Exclusion of other employee benefits:																
117	Premiums on group term life insurance	1,800	1,830	1,860	1,890	1,920	1,950	1,990	9,610	....	....	....	....	....	....	....	....
118	Premiums on accident and disability insurance	....	....	....	....	....	....	....	....	230	240	250	260	270	280	290	1,350
119	Small business retirement plan credit	20	40	50	70	70	80	80	350	20	40	50	60	70	70	70	320
120	Income of trusts to finance supplementary unemployment benefits	....	....	....	....	....	....	....	....	30	30	30	30	30	30	30	....
121	Special ESOP rules	1460	1570	1690	1820	1970	2120	2280	9,880	320	350	370	400	430	460	500	2,160
122	Additional deduction for the blind	....	....	....	....	....	....	....	....	40	30	40	40	40	40	40	200
123	Additional deduction for the elderly	....	....	....	....	....	....	....	....	1,840	1,710	1,800	1,900	1,960	1,920	1,940	9,520
124	Tax credit for the elderly and disabled	....	....	....	....	....	....	....	....	20	10	10	10	10	10	10	50
125	Deductibility of casualty losses	....	....	....	....	....	....	....	....	500	690	670	680	640	600	630	3,220
126	Earned income tax credit[5]	....	....	....	....	....	....	....	....	5,099	4,884	5,006	5,477	5,515	5,603	5,780	27,381
	Social Security																
	Exclusion of social security benefits:																
127	Social Security benefits for retired workers	....	....	....	....	....	....	....	....	18,600	19,620	19,040	19,370	20,390	19,710	19,910	98,420
128	Social Security benefits for disabled	....	....	....	....	....	....	....	....	3,230	3,570	3,720	3,840	4,080	4,280	4,500	20,420
129	Social Security benefits for dependents and survivors	....	....	....	....	....	....	....	....	4,060	4,380	4,310	4,160	4,190	4,030	4,040	20,730
	Veterans Benefits and Services																
130	Exclusion of veterans death benefits and disability compensation	....	....	....	....	....	....	....	....	3,320	3,330	3,600	3,930	4,170	4,300	4,560	20,560
131	Exclusion of veterans pensions	....	....	....	....	....	....	....	....	100	100	100	110	110	110	120	550
132	Exclusion of GI bill benefits	....	....	....	....	....	....	....	....	110	120	130	130	160	170	170	760
133	Exclusion of interest on veterans housing bonds	10	10	10	10	10	10	10	50	30	40	40	40	50	50	50	230

Table 18–2. ESTIMATES OF TAX EXPENDITURES FOR THE CORPORATE AND INDIVIDUAL INCOME TAXES—Continued

(in millions of dollars)

		Corporations								Individuals							
		2003	2004	2005	2006	2007	2008	2009	2005–09	2003	2004	2005	2006	2007	2008	2009	2005–09
	General Purpose Fiscal Assistance																
134	Exclusion of interest on public purpose State and local bonds	5,710	5,880	6,060	6,240	6,420	6,620	6,820	32,160	19,770	20,100	20,310	20,200	19,730	20,320	20,930	101,490
135	Deductibility of nonbusiness State and local taxes other than on owner-occupied homes	....	....	....	....	....	....	....	....	49,770	49,470	46,180	39,100	35,930	34,710	34,370	190,290
136	Tax credit for corporations receiving income from doing business in U.S. possessions	1,200	1,150	1,100	800	....	....	....	1,900	....	....	....	....	....	....	....	....
	Interest																
137	Deferral of interest on U.S. savings bonds	....	....	....	....	....	....	....	....	30	40	40	40	40	40	50	210
	Addendum: Aid to State and local governments:																
	Deductibility of:																
	Property taxes on owner-occupied homes	....	....	....	....	....	....	....	....	22,090	21,740	19,410	16,110	14,580	13,640	13,110	76,850
	Nonbusiness State and local taxes other than on owner-occupied homes	....	....	....	....	....	....	....	....	49,770	49,470	46,180	39,100	35,930	34,710	34,370	190,290
	Exclusion of interest on State and local bonds for:																
	Public purposes	5,710	5,880	6,060	6,240	6,420	6,620	6,820	32,160	19,770	20,100	20,310	20,200	19,730	20,320	20,930	101,490
	Energy facilities	20	20	20	20	20	20	20	100	70	80	90	90	100	110	110	500
	Water, sewage, and hazardous waste disposal facilities	100	100	100	110	110	110	120	550	350	390	430	460	480	520	530	2,420
	Small-issues	80	90	90	90	100	100	100	480	310	340	380	400	420	450	470	2,120
	Owner-occupied mortgage subsidies	200	200	210	220	220	230	240	1,120	710	790	870	930	980	1,050	1,080	4,910
	Rental housing	60	60	70	70	70	70	70	350	220	250	280	300	310	330	340	1,560
	Airports, docks, and similar facilities	170	170	180	180	190	190	200	940	600	670	730	790	830	890	910	4,150
	Student loans	60	60	60	60	60	60	70	310	200	220	250	260	280	300	310	1,400
	Private nonprofit educational facilities	170	170	180	190	190	200	200	960	610	680	750	800	840	900	930	4,220
	Hospital construction	350	360	370	390	400	410	420	1,990	1,270	1,420	1,560	1,670	1,760	1,880	1,940	8,810
	Veterans' housing	10	10	10	10	10	10	10	50	30	40	40	40	50	50	50	230
	Credit for holders of zone academy bonds	80	90	110	130	130	140	140	650	....	....	....	....	....	....	....	....

[1] In addition, the partial exemption from the excise tax for alcohol fuels results in a reduction in excise tax receipts (in millions of dollars) as follows: 2003 $1,100; 2004 $1,260; 2005 $1,370; 2006 $1,430; 2007 $1,470; 2008 $1,510; and 2009 $1,550.

[2] If corporate equity were to be included, the revenue loss estimates would be $48,540 in 2003, $51,510 in 2004, $56,970 in 2005, $62,140 in 2006, $68,690 in 2007, $92,320 in 2008, and $55,110 in 2009. Similarly, if the reduced tax rate on dividends were to be included, the revenue loss estimates would be $1,810 in 2003, $16,720 in 2004, $13,280 in 2005, $13,880 in 2006, $14,480 in 2007, $15,970 in 2008, and $8,540 in 2009.

[3] The figures in the table indicate the effect of the child tax credit on receipts. The effect of the credit on outlays (in millions of dollars) is as follows: 2003 $6,435; 2004 $7,447; 2005 $11,486; 2006 $8,440; 2007 $8,237; 2008 $7,956; and 2009 $7,909

[4] In addition to the receipts shown outlays of $60 million in 2004, $90 million in 2005, $100 million in 2006, $120 million in 2007, $130 million in 2008, and $140 million in 2009 are projected.

[5] The figures in the table indicate the effect of the earned income tax credit on receipts. The effect of the credit on outlays (in millions of dollars) is as follows: 2003 $31,961; 2004 $33,551; 2005 $34,148; 2006 $34,488; 2007 $34,338; 2008 $34,359; and 2009 $35,161.

Note: Provisions with estimates denoted normal tax method have no revenue loss under the reference tax law method.

All estimates have been rounded to the nearest $10 million. Provisions with estimates that rounded to zero in each year are not included in the table.

Table 18–3. INCOME TAX EXPENDITURES RANKED BY TOTAL 2005–2009 PROJECTED REVENUE EFFECT

(in millions of dollars)

Provision	2005	2005–2009
Exclusion of employer contributions for medical insurance premiums and medical care	112,990	653,670
Deductibility of mortgage interest on owner-occupied homes	69,740	393,910
Net exclusion of pension contributions and earnings: 401(k) plans	58,910	332,520
Net exclusion of pension contributions and earnings: Employer plans	61,740	309,530
Deductibility of nonbusiness state and local taxes other than on owner-occupied homes	46,180	190,290
Capital gains (except agriculture, timber, iron ore, and coal)	30,190	177,670
Deductibility of charitable contributions, other than education and health	29,670	172,920
Exclusion of interest on public purpose State and local bonds	26,370	133,650
Exclusion of interest on life insurance savings	22,130	131,110
Child credit	29,860	129,260
Capital gains exclusion on home sales	21,490	114,100
Step-up basis of capital gains at death	18,240	110,920
Net exclusion of pension contributions and earnings: Individual Retirement Accounts	20,090	100,050
Social Security benefits for retired workers	19,040	98,420
Deductibility of State and local property tax on owner-occupied homes	19,410	76,850
Net exclusion of pension contributions and earnings: Keough Plans	9,260	53,630
Deferral of income from controlled foreign corporations (normal tax method)	8,400	48,010
Deductibility of medical expenses	7,900	46,750
Exclusion of workers' compensation benefits	6,850	38,710
Credit for low-income housing investments	6,860	37,550
Extraterritorial income exclusion	5,890	33,810
Expensing of research and experimentation expenditures (normal tax method)	4,500	31,830
Earned income tax credit	5,006	27,381
Graduated corporation income tax rate (normal tax method)	3,910	23,290
Deductibility of self-employed medical insurance premiums	3,780	22,140
Social Security benefits for dependents and survivors	4,310	20,730
Deductibility of charitable contributions (education)	3,660	21,230
Exclusion of veterans death benefits and disability compensation	3,600	20,560
Social Security benefits for disabled	3,720	20,420
Exception from passive loss rules for $25,000 of rental loss	4,390	20,120
Deductibility of charitable contributions (health)	3,350	19,510
HOPE tax credit	3,510	16,760
Exclusion of income earned abroad by U.S. citizens	2,750	14,870
Exclusion of reimbursed employee parking expenses	2,360	13,080
Special ESOP rules	2,060	12,040
Exclusion of benefits and allowances to armed forces personnel	2,260	11,540
Lifetime Learning tax credit	2,180	11,240
Exclusion of interest on hospital construction bonds	1,930	10,800
Credit for child and dependent care expenses	2,690	10,610
Premiums on group term life insurance	1,860	9,610
Additional deduction for the elderly	1,800	9,520
Inventory property sales source rules exception	1,700	9,430
Parental personal exemption for students age 19 or over	2,550	9,320
Exemption of credit union income	1,430	7,880
Exclusion of scholarship and fellowship income (normal tax method)	1,340	6,990
Empowerment zones, Enterprise communities, and Renewal communities	1,120	6,850
Capital gains treatment of certain income	1,160	6,430
Expensing of certain small investments (normal tax method)	4,850	6,110
Exclusion of interest on owner-occupied mortgage subsidy bonds	1,080	6,030
Deferral of income from post 1987 installment sales	1,120	5,810
Deferred taxes for financial firms on certain income earned overseas	2,190	5,410
Deduction for higher education expenses	2,580	5,190
Exclusion of interest on bonds for private nonprofit educational facilities	930	5,180
Exclusion of interest for airport, dock, and similar bonds	910	5,090
Exclusion of employee meals and lodging (other than military)	850	4,640
Exclusion of certain allowances for Federal employees abroad	840	4,610
Employer provided child care exclusion	770	4,530
Credit for increasing research activities	2,550	4,310
Deductibility of student-loan interest	780	4,070
New markets tax credit	430	3,530
Deductibility of casualty losses	670	3,220
Exclusion of employer-provided educational assistance	560	3,120
Low and moderate income savers credit	1,100	3,040
Alternative fuel production credit	890	3,020
Excess of percentage over cost depletion, fuels	580	3,000
Exclusion of interest on bonds for water, sewage, and hazardous waste facilities	530	2,970
Exclusion for employer-provided transit passes	450	2,950
Adoption credit and exclusion	500	2,750
Carryover basis of capital gains on gifts	450	2,740

Table 18–3. INCOME TAX EXPENDITURES RANKED BY TOTAL 2005–2009 PROJECTED REVENUE EFFECT—Continued

(in millions of dollars)

Provision	2005	2005–2009
Exclusion of interest on small issue bonds	470	2,600
State prepaid tuition plans	320	2,510
Exclusion of parsonage allowances	420	2,400
Exclusion of certain foster care payments	440	2,390
Exclusion of public assistance benefits (normal tax method)	430	2,350
Assistance for adopted foster children	330	2,160
Enhanced oil recovery credit	410	2,150
Exclusion of railroad retirement system benefits	400	2,000
Expensing of multiperiod timber growing costs	350	1,910
Exclusion of interest on rental housing bonds	350	1,910
Tax credit for corporations receiving income from doing business in U.S. possessions	1,100	1,900
New technology credit	370	1,850
Exclusion of interest on student-loan bonds	310	1,710
Tax incentives for preservation of historic structures	300	1,660
Capital gains exclusion of small corporation stock	210	1,500
Special Blue Cross/Blue Shield deduction	310	1,450
Excess of percentage over cost depletion, nonfuel minerals	260	1,350
Premiums on accident and disability insurance	250	1,350
Tax credit for orphan drug research	200	1,260
Tax exemption of certain insurance companies owned by tax-exempt organizations	220	1,250
Education Individual Retirement Accounts	140	1,240
Employer-provided child care credit	140	800
Exclusion of GI bill benefits	130	760
Amortization of start-up costs (normal tax method)	130	760
Expensing of certain capital outlays	130	710
Special alternative tax on small property and casualty insurance companies	130	680
Small business retirement plan credit	100	670
Credit for holders of zone academy bonds	110	650
Capital gains treatment of royalties on coal	120	640
Capital gains treatment of certain timber income	120	640
Exclusion of interest on energy facility bonds	110	600
Exclusion of military disability pensions	110	570
Exclusion of veterans pensions	100	550
Expensing of certain multiperiod production costs	90	490
Small life insurance company deduction	90	450
Income averaging for farmers	80	420
Expensing of exploration and development costs, fuels	170	420
Exclusion from income of conservation subsidies provided by public utilities	80	400
Exemption of certain mutuals' and cooperatives' income	70	350
Tax credit for health insurance purchased by certain displaced and retired individuals	60	340
Credit for disabled access expenditures	60	300
Exclusion of interest on veterans housing bonds	50	280
Work opportunity tax credit	170	270
Exceptions from imputed interest rules	50	250
Ordinary income treatment of loss from small business corporation stock sale	50	250
Exclusion of special benefits for disabled coal miners	50	230
Deferral of interest on U.S. savings bonds	40	210
Additional deduction for the blind	40	200
Cancellation of indebtedness	30	180
Alcohol fuel credits [1]	30	150
Investment credit for rehabilitation of structures (other than historic)	30	150
Deferral of tax on shipping companies	20	100
Exception from passive loss limitation for working interests in oil and gas properties	20	100
Welfare-to-work tax credit	40	90
Exclusion of interest on savings bonds redeemed to finance educational expenses	10	80
Deferral of gain on sale of farm refiners	10	80
Expensing of exploration and development costs, nonfuel minerals	10	50
Tax credit for the elderly and disabled	10	50
Treatment of loans forgiven for solvent farmers	10	50
Income of trusts to finance supplementary unemployment benefits	30	....
Expensing of environmental remediation costs	–10	–50
Tax credit and deduction for clean-fuel burning vehicles	10	–210
Medical Savings Accounts	–570	–7,010
Accelerated depreciation on rental housing (normal tax method)	–170	–12,070
Accelerated depreciation of buildings other than rental housing (normal tax method)	–4,060	–40,160
Accelerated depreciation of machinery and equipment (normal tax method)	–10,920	–136,260

Table 18–4. PRESENT VALUE OF SELECTED TAX EXPENDITURES FOR ACTIVITY IN CALENDAR YEAR 2003

(in millions of dollars)

	Provision	Present Value of Revenue Loss
1	Deferral of income from controlled foreign corporations (normal tax method)	7,630
2	Deferred taxes for financial firms on income earned overseas	2,080
3	Expensing of research and experimentation expenditures (normal tax method)	2,000
4	Expensing of exploration and development costs—fuels	120
5	Expensing of multiperiod timber growing costs	200
6	Expensing of certain multiperiod production costs—agriculture	170
7	Expensing of certain capital outlays—agriculture	200
8	Deferral of income on life insurance and annuity contracts	25,060
9	Expensing of certain small investments (normal tax method)	690
10	Amortization of start-up costs (normal tax method)	70
11	Deferral of tax on shipping companies	20
12	Credit for holders of zone academy bonds	110
13	Credit for low-income housing investments	3,470
14	Deferral for state prepaid tuition plans	1,510
15	Exclusion of pension contributions—employer plans	102,470
16	Exclusion of 401(k) contributions	81,610
17	Exclusion of IRA contributions and earnings	11,030
18	Exclusion of contributions and earnings for Keogh plans	9,530
19	Exclusion of interest on public-purpose bonds	19,440
20	Exclusion of interest on non-public purpose bonds	6,120
21	Deferral of interest on U.S. savings bonds	440

Outlay Equivalents

The concept of "outlay equivalents" is another theoretical measure of the budget effect of tax expenditures. It is the amount of budget outlays that would be required to provide the taxpayer the same after-tax income as would be received through the tax provision. The outlay-equivalent measure allows the cost of a tax expenditure to be compared with a direct Federal outlay on a more even footing. Outlay equivalents are reported in Table 18–5.

Table 18–5. OUTLAY EQUVALENT ESTIMATES FOR TAX EXPENDITURES

(in millions of dollars)

		2003	2004	2005	2006	2007	2008	2009	2005–09
	National Defense								
1	Exclusion of benefits and allowances to armed forces personnel	2,570	2,600	2,620	2,650	2,680	2,710	2,740	13,400
	International Affairs								
2	Exclusion of income earned abroad by U.S. citizens	3,470	3,530	3,640	3,700	3,880	4,100	4,320	19,640
3	Exclusion of certain allowances for Federal employees abroad	980	1,030	1,070	1,120	1,180	1,230	1,290	5,890
4	Extraterritorial income exclusion	7,920	8,480	9,060	9,680	10,350	11,080	11,850	52,020
5	Inventory property sales source rules exception	2,370	2,490	2,620	2,750	2,890	3,050	3,200	14,510
6	Deferral of income from controlled foreign corporations (normal tax method)	7,450	7,900	8,400	8,930	9,550	10,210	10,920	48,010
7	Deferred taxes for financial firms on certain income earned overseas	2,050	2,130	2,190	2,260	960	....	....	5,410
	General Science, Space, and Technology								
8	Expensing of research and experimentation expenditures (normal tax method)	–1,980	–2,350	4,500	8,290	7,110	6,360	5,570	31,830
9	Credit for increasing research activities	7,620	6,760	3,930	1,680	700	230	90	6,630
	Energy								
10	Expensing of exploration and development costs, fuels	230	290	190	80	70	70	50	460
11	Excess of percentage over cost depletion, fuels	910	780	760	810	820	810	820	4,020
12	Alternative fuel production credit	1,720	1,190	1,190	1,190	1,190	470	....	4,040
13	Exception from passive loss limitation for working interests in oil and gas properties	20	20	20	20	20	20	20	100
14	Capital gains treatment of royalties on coal	140	150	150	160	170	180	190	850
15	Exclusion of interest on energy facility bonds	130	150	160	160	170	190	190	870
16	Enhanced oil recovery credit	620	630	650	660	680	700	720	3,410
17	New technology credit	380	470	490	490	490	500	500	2,470
18	Alcohol fuel credits [1]	30	30	30	30	30	30	30	150
19	Tax credit and deduction for clean-fuel burning vehicles	90	80	20	–30	–90	–90	–100	–290
20	Exclusion from income of conservation subsidies provided by public utilities	110	110	110	110	100	100	100	520
	Natural Resources and Environment								
21	Expensing of exploration and development costs, nonfuel minerals	10	10	10	10	10	10	10	50
22	Excess of percentage over cost depletion, nonfuel minerals	320	330	330	360	370	370	390	1,820
23	Exclusion of interest on bonds for water, sewage, and hazardous waste facilities	650	700	760	820	850	900	940	4,270

Table 18–5. OUTLAY EQUVALENT ESTIMATES FOR TAX EXPENDITURES—Continued

(in millions of dollars)

		2003	2004	2005	2006	2007	2008	2009	2005–09
24	Capital gains treatment of certain timber income	140	150	150	160	170	180	190	850
25	Expensing of multiperiod timber growing costs	450	450	460	470	490	520	530	2,470
26	Tax incentives for preservation of historic structures	270	290	300	320	330	340	370	1,660
	Agriculture								
27	Expensing of certain capital outlays	150	160	160	160	170	180	190	860
28	Expensing of certain multiperiod production costs	110	110	110	110	110	120	110	560
29	Treatment of loans forgiven for solvent farmers	10	10	10	10	10	10	10	50
30	Capital gains treatment of certain income	1,400	1,470	1,550	1,630	1,710	1,800	1,890	8,580
31	Income averaging for farmers	90	90	90	100	100	100	110	500
32	Deferral of gain on sale of farm refiners	10	20	20	20	20	20	20	100
	Commerce and Housing								
	Financial institutions and insurance:								
33	Exemption of credit union income	1,650	1,730	1,820	1,910	2,000	2,100	2,210	10,040
34	Excess bad debt reserves of financial institutions	50	38	25	25	13	....	....	63
35	Exclusion of interest on life insurance savings	22,000	23,840	25,730	27,920	30,290	32,860	35,650	152,450
36	Special alternative tax on small property and casualty insurance companies	170	170	180	180	200	200	200	960
37	Tax exemption of certain insurance companies owned by tax-exempt organizations	270	300	310	340	350	370	390	1,760
38	Small life insurance company deduction	120	120	120	120	120	120	120	600
	Housing:								
39	Exclusion of interest on owner-occupied mortgage subsidy bonds	1,310	1,420	1,550	1,660	1,730	1,840	1,890	8,670
40	Exclusion of interest on rental housing bonds	400	440	510	530	550	580	590	2,760
41	Deductibility of mortgage interest on owner-occupied homes	61,160	62,590	69,740	74,800	78,420	83,030	87,920	393,910
42	Deductibility of State and local property tax on owner-occupied homes	22,090	21,740	19,410	16,110	14,580	13,640	13,110	76,850
43	Deferral of income from post 1987 installment sales	1,060	1,080	1,100	1,120	1,140	1,170	1,190	5,720
44	Capital gains exclusion on home sales	26,570	27,367	28,188	29,034	29,905	30,802	31,726	149,655
45	Exception from passive loss rules for $25,000 of rental loss	5,710	4,570	4,390	4,210	4,020	3,840	3,660	20,120
46	Credit for low-income housing investments	4,670	4,920	5,160	5,390	5,620	5,880	6,170	28,220
47	Accelerated depreciation on rental housing (normal tax method)	1,220	620	–170	–1,110	–2,330	–3,560	–4,900	–12,070
	Commerce:								
48	Cancellation of indebtedness	20	30	30	30	40	40	40	180
49	Exceptions from imputed interest rules	50	50	50	50	50	50	50	250
50	Capital gains (except agriculture, timber, iron ore, and coal)	34,310	36,400	40,260	43,910	48,540	65,240	38,950	236,900
51	Capital gains exclusion of small corporation stock	170	220	270	340	400	460	530	2,000
52	Step-up basis of capital gains at death	19,840	21,710	24,320	26,990	29,650	32,260	34,680	147,900
53	Carryover basis of capital gains on gifts	590	390	450	540	550	580	620	2,740
54	Ordinary income treatment of loss from small business corporation stock sale	50	60	60	60	60	60	60	300
55	Accelerated depreciation of buildings other than rental housing (normal tax method)	–2,290	–3,190	–4,060	–4,690	–6,810	–10,170	–14,430	–40,160
56	Accelerated depreciation of machinery and equipment (normal tax method)	48,520	46,800	–10,920	–37,940	–31,040	–28,770	–27,590	–136,260
57	Expensing of certain small investments (normal tax method)	1,030	1,590	4,850	1,650	–490	–30	130	6,110
58	Amortization of start-up costs (normal tax method)	110	120	130	150	160	160	160	760
59	Graduated corporation income tax rate (normal tax method)	4,670	4,760	6,020	7,150	7,390	7,520	7,760	35,840
60	Exclusion of interest on small issue bonds	560	610	670	700	750	790	820	3,730
	Transportation								
61	Deferral of tax on shipping companies	20	20	20	20	20	20	20	100
62	Exclusion of reimbursed employee parking expenses	2,750	2,900	3,050	3,210	3,370	3,540	3,710	16,880
63	Exclusion for employer-provided transit passes	400	480	560	650	740	820	910	3,680
	Community and Regional Development								
64	Investment credit for rehabilitation of structures (other than historic)	30	30	30	30	30	30	30	150
65	Exclusion of interest for airport, dock, and similar bonds	1,110	1,210	1,310	1,390	1,460	1,550	1,600	7,310
66	Exemption of certain mutuals' and cooperatives' income	70	80	80	80	80	80	90	410
67	Empowerment zones, Enterprise communities, and Renewal communities	1,070	1,080	1,120	1,210	1,320	1,470	1,730	6,850
68	New markets tax credit	190	290	430	610	830	870	790	3,530
69	Expensing of environmental remediation costs	110	40	–20	–10	–10	–10	–10	–60
	Education, Training, Employment, and Social Services								
	Education:								
70	Exclusion of scholarship and fellowship income (normal tax method)	1,390	1,380	1,480	1,540	1,550	1,560	1,560	7,690
71	HOPE tax credit	4,210	4,390	4,500	4,210	4,270	4,250	4,250	21,480
72	Lifetime Learning tax credit	2,440	2,890	2,800	2,720	2,970	2,970	2,950	14,410
73	Education Individual Retirement Accounts	90	130	180	240	310	390	470	1,590
74	Deductibility of student-loan interest	870	900	930	960	980	990	990	4,850
75	Deduction for higher education expenses	2,210	2,320	3,310	3,340	....	....	....	6,650
76	State prepaid tuition plans	50	150	320	430	510	590	660	2,510
77	Exclusion of interest on student-loan bonds	370	400	440	460	490	510	550	2,450
78	Exclusion of interest on bonds for private nonprofit educational facilities	1,120	1,220	1,340	1,420	1,480	1,580	1,630	7,450
79	Credit for holders of zone academy bonds	110	130	160	180	190	200	200	930
80	Exclusion of interest on savings bonds redeemed to finance educational expenses	20	20	20	20	20	20	20	100
81	Parental personal exemption for students age 19 or over	3,480	3,470	2,820	2,220	1,950	1,750	1,580	10,320

Table 18–5. OUTLAY EQUVALENT ESTIMATES FOR TAX EXPENDITURES—Continued

(in millions of dollars)

		2003	2004	2005	2006	2007	2008	2009	2005–09
82	Deductibility of charitable contributions (education)	3,670	3,390	3,660	4,000	4,230	4,510	4,830	21,230
83	Exclusion of employer-provided educational assistance	620	660	690	730	770	810	860	3,860
84	Special deduction for teacher expenses	180	170	....	....	....	....	....	....
	Training, employment, and social services:								
85	Work opportunity tax credit	430	370	170	70	30	....	....	270
86	Welfare-to-work tax credit	60	60	40	30	20	....	....	90
87	Employer provided child care exclusion	790	830	1,030	1,160	1,230	1,280	1,350	6,050
88	Employer-provided child care credit	120	170	190	200	220	230	240	1,080
89	Assistance for adopted foster children	280	330	370	420	480	540	610	2,420
90	Adoption credit and exclusion	280	570	640	690	710	730	750	3,520
91	Exclusion of employee meals and lodging (other than military)	950	990	1,030	1,080	1,130	1,180	1,210	5,630
92	Child credit [2]	50,520	25,950	39,010	32,280	31,960	31,450	31,450	166,150
93	Credit for child and dependent care expenses	3,630	3,930	3,590	2,950	2,710	2,530	2,370	14,150
94	Credit for disabled access expenditures	70	70	70	70	70	80	80	370
95	Deductibility of charitable contributions, other than education and health	30,020	27,370	29,670	32,550	34,500	36,790	39,410	172,920
96	Exclusion of certain foster care payments	490	500	510	520	530	540	650	2,750
97	Exclusion of parsonage allowances	460	490	520	550	580	620	660	2,930
	Health								
98	Exclusion of employer contributions for medical insurance premiums and medical care	129,010	133,400	141,590	151,940	163,510	176,320	190,300	823,660
99	Deductibility of self-employed medical insurance premiums	3,170	4,640	4,610	4,990	5,310	5,770	6,250	26,930
100	Medical Savings Accounts/Health Savings Accounts	–40	–180	–730	–1,230	–1,780	–2,460	–2,800	–9,000
101	Deductibility of medical expenses	6,700	7,400	8,540	9,170	9,930	11,060	11,930	50,630
102	Exclusion of interest on hospital construction bonds	2,330	2,560	2,770	2,960	3,110	3,290	3,390	15,520
103	Deductibility of charitable contributions (health)	3,390	3,090	3,350	3,670	3,890	4,150	4,450	19,510
104	Tax credit for orphan drug research	240	270	300	330	370	420	470	1,890
105	Special Blue Cross/Blue Shield deduction	440	400	390	350	390	330	360	1,820
106	Tax credit for health insurance purchased by certain displaced and retired individuals [3]	....	60	80	80	90	90	100	440
	Income Security								
107	Exclusion of railroad retirement system benefits	400	400	400	400	400	400	400	2,000
108	Exclusion of workers' compensation benefits	6,100	6,460	6,850	7,270	7,710	8,190	8,690	38,710
109	Exclusion of public assistance benefits (normal tax method)	400	410	430	450	470	490	510	2,350
110	Exclusion of special benefits for disabled coal miners	60	60	50	50	50	40	40	230
111	Exclusion of military disability pensions	100	110	110	110	110	120	120	570
	Net exclusion of pension contributions and earnings:								
112	Employer plans	72980	72410	75290	80900	76400	71170	73710	377,470
113	401(k) plans	63260	69200	71840	74800	80180	86680	92000	405,500
114	Individual Retirement Accounts	26220	26390	26910	27530	27010	26640	26320	134,410
115	Low and moderate income savers credit	880	960	1100	1210	730	....	....	3,040
116	Keogh plans	7640	11040	11660	12360	13140	14320	15600	67,080
	Exclusion of other employee benefits:								
117	Premiums on group term life insurance	2,400	2,440	2,480	2,520	2,560	2,600	2,650	12,810
118	Premiums on accident and disability insurance	310	320	330	350	360	370	390	1,800
119	Small business retirement plan credit	60	110	140	190	200	210	210	950
120	Income of trusts to finance supplementary unemployment benefits	30	30	30	30	30	30	30	150
121	Special ESOP rules	2,850	3,060	3,280	3,520	3,800	4,080	4,360	19,040
122	Additional deduction for the blind	40	40	40	40	40	40	50	210
123	Additional deduction for the elderly	2,220	2,070	2,180	2,290	2,380	2,330	2,350	11,530
124	Tax credit for the elderly and disabled	30	20	20	20	10	10	10	70
125	Deductibility of casualty losses	550	760	740	750	640	600	630	3,360
126	Earned income tax credit [4]	5,666	5,427	5,562	6,085	6,127	6,226	6,422	30,422
	Social Security								
	Exclusion of social security benefits:								
127	Social Security benefits for retired workers	18,600	19,620	19,040	19,370	20,390	19,710	19,910	98,420
128	Social Security benefits for disabled	3,230	3,570	3,720	3,840	4,080	4,280	4,500	20,420
129	Social Security benefits for dependents and survivors	4,060	4,380	4,310	4,160	4,190	4,030	4,040	20,730
	Veterans Benefits and Services								
130	Exclusion of veterans death benefits and disability compensation	3,320	3,330	3,600	3,930	4,170	4,300	4,560	20,560
131	Exclusion of veterans pensions	100	100	100	110	110	110	120	550
132	Exclusion of GI bill benefits	110	120	130	130	160	170	170	760
133	Exclusion of interest on veterans housing bonds	50	70	70	70	80	80	80	380
	General Purpose Fiscal Assistance								
134	Exclusion of interest on public purpose State and local bonds	36,550	37,270	37,830	37,920	37,490	38,620	39,770	191,630
135	Deductibility of nonbusiness State and local taxes other than on owner-occupied homes	49,770	49,470	46,180	39,100	35,930	34,710	34,370	190,290
136	Tax credit for corporations receiving income from doing business in U.S. possessions	1,710	1,640	1,570	1,140	....	....	....	2,710
	Interest								
137	Deferral of interest on U.S. savings bonds	30	40	40	40	40	40	50	210

Table 18–5. OUTLAY EQUVALENT ESTIMATES FOR TAX EXPENDITURES—Continued

(in millions of dollars)

		2003	2004	2005	2006	2007	2008	2009	2005–09
	Addendum: Aid to State and local governments:								
	Deductibility of:								
	Property taxes on owner-occupied homes	22,090	21,740	19,410	16,110	14,580	13,640	13,110	76,850
	Nonbusiness State and local taxes other than on owner-occupied homes	49,770	49,470	46,180	39,100	35,930	34,710	34,370	190,290
	Exclusion of interest on State and local bonds for:								
	Public purposes	36,550	37,270	37,830	37,920	37,490	38,620	39,770	191,630
	Energy facilities	130	150	160	160	170	190	190	870
	Water, sewage, and hazardous waste disposal facilities	650	700	760	820	850	900	940	4,270
	Small-issues	560	610	670	700	750	790	820	3,730
	Owner-occupied mortgage subsidies	1,310	1,420	1,550	1,660	1,730	1,840	1,890	8,670
	Rental housing	400	440	510	530	550	580	590	2,760
	Airports, docks, and similar facilities	1,110	1,210	1,310	1,390	1,460	1,550	1,600	7,310
	Student loans	370	400	440	460	490	510	550	2,450
	Private nonprofit educational facilities	1,120	1,220	1,340	1,420	1,480	1,580	1,630	7,450
	Hospital construction	2,330	2,560	2,770	2,960	3,110	3,290	3,390	15,520
	Veterans' housing	50	70	70	70	80	80	80	380
	Credit for holders of zone academy bonds	110	130	160	180	190	200	200	930

[1] In addition, the partial exemption from the excise tax for alcohol fuels results in a reduction in excise tax receipts (in millions of dollars) as follows: 2002 $1,070; 2003 $1,140; 2004 $1,230; 2005 $1,320; 2006 $1,370; 2007 $1,400; and 2008 $1,430.

[2] The figures in the table indicate the effect of the child tax credit on receipts. The effect of the credit on outlays (in millions of dollars) is as follows: 2001 $980; 2002 $5,060 2003 $5,870; 2004 $5,860; 2005 $5,700; 2006 $7,630; 2007 $7,630; and 2008 $7,500

[3] In addition to the outlay equivalents shown outlays of $60 million in 2004, $90 million in 2005, $100 million in 2006, $120 million in 2007, $130 million in 2008, and $140 million in 2009 are projected.

[4] The figures in the table indicate the effect of the earned income tax credit on receipts. The effect of the credit on outlays (in millions of dollars) is as follows: 2002 $27,830; 2003 $30,610; 2004 $31,380; 2005 $32,090; 2006 $33,450; 2007 $34,480; and 2008 $35,380.

Note: Provisions with estimates denoted normal tax method have no revenue loss under the reference tax law method.

All estimates have been rounded to the nearest $10 million. Provisions with estimates that rounded to zero in each year are not included in the table.

Tax Expenditure Baselines

A tax expenditure is an exception to baseline provisions of the tax structure. The 1974 Congressional Budget Act, which mandated the tax expenditure budget, did not specify the baseline provisions of the tax law. As noted previously, deciding whether provisions are exceptions, therefore, is a matter of judgment. As in prior years, most of this year's tax expenditure estimates are presented using two baselines: the normal tax baseline and the reference tax law baseline. An exception is provided for the reduction in the tax rate on dividends and capital gains on corporate shares by the Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA), as dicussed below.

The normal tax baseline is patterned on a comprehensive income tax, which defines income as the sum of consumption and the change in net wealth in a given period of time. The normal tax baseline allows personal exemptions, a standard deduction, and deductions of the expenses incurred in earning income. It is not limited to a particular structure of tax rates, or by a specific definition of the taxpaying unit.

The reference tax law baseline is also patterned on a comprehensive income tax, but it is closer to existing law. Tax expenditures under the reference law baseline are generally tax expenditures under the normal tax baseline, but the reverse is not always true.

Both the normal and reference tax baselines allow several major departures from a pure comprehensive income tax. For example:

- Income is taxable only when it is realized in exchange. Thus, neither the deferral of tax on unrealized capital gains nor the tax exclusion of imputed income (such as the rental value of owner-occupied housing or farmers' consumption of their own produce) is regarded as a tax expenditure. Both accrued and imputed income would be taxed under a comprehensive income tax.
- A comprehensive income tax would generally not exclude from the tax base amounts for personal exemptions or a standard deduction, except perhaps to ease tax administration.
- There generally is a separate corporate income tax.
- Values of assets and debt are not generally adjusted for inflation. A comprehensive income tax would adjust the cost basis of capital assets and debt for changes in the price level during the time the assets or debt are held. Thus, under a comprehensive income tax baseline, the failure to take account of inflation in measuring depreciation, capital gains, and interest income would be regarded as a negative tax expenditure (i.e., a tax penalty), and failure to take account of inflation in measuring interest costs would be regarded as a positive tax expenditure (i.e., a tax subsidy).

Although the reference law and normal tax baselines are generally similar, areas of difference include:

Tax rates. The separate schedules applying to the various taxpaying units are included in the reference law baseline. Thus, corporate tax rates below the maximum statutory rate do not give rise to a tax expenditure. The normal tax baseline is similar, except that, by convention, it specifies the current maximum rate as the baseline for the corporate income tax. The lower tax rates applied to the first $10 million of corporate income are thus regarded as a tax expenditure. Again by convention, the alternative minimum tax is treated as part of the baseline rate structure under both the reference and normal tax methods.

Income subject to the tax. Income subject to tax is defined as gross income less the costs of earning that income. The Federal income tax defines gross income to include: (1) consideration received in the exchange of goods and services, including labor services or property; and (2) the taxpayer's share of gross or net income earned and/or reported by another entity (such as a partnership). Under the reference tax rules, therefore, gross income does not include gifts—defined as receipts of money or property that are not consideration in an exchange—or most transfer payments, which can be thought of as gifts from the Government.[1] The normal tax baseline also excludes gifts between individuals from gross income. Under the normal tax baseline, however, all cash transfer payments from the Government to private individuals are counted in gross income, and exemptions of such transfers from tax are identified as tax expenditures. The costs of earning income are generally deductible in determining taxable income under both the reference and normal tax baselines.[2]

Capital recovery. Under the reference tax law baseline no tax expenditures arise from accelerated depreciation. Under the normal tax baseline, the depreciation allowance for property is computed using estimates of economic depreciation. The latter represents a change in the calculation of the tax expenditure under normal law first made in the 2004 Budget. The Appendix provides further details on the new methodology and how it differs from the prior methodology.

Treatment of foreign income. Both the normal and reference tax baselines allow a tax credit for foreign income taxes paid (up to the amount of U.S. income taxes that would otherwise be due), which prevents double taxation of income earned abroad. Under the normal tax method, however, controlled foreign corporations (CFCs) are not regarded as entities separate from their controlling U.S. shareholders. Thus, the deferral of tax on income received by CFCs is regarded as a tax expenditure under this method. In contrast, except for tax haven activities, the reference law baseline follows current law in treating CFCs as separate taxable entities whose income is not subject to U.S. tax until distributed to U.S. taxpayers. Under this baseline, deferral of tax on CFC income is not a tax expenditure because U.S. taxpayers generally are not taxed on accrued, but unrealized, income.

In addition to these areas of difference, the Joint Committee on Taxation considers a somewhat broader set of tax expenditures under its normal tax baseline than is considered here.

Treatment of JGTRRA's Cut in the Tax Rates on Dividends and Capital Gains

Although not in line with previous reference tax law or normal tax law baselines, our tables exclude from the list of tax expenditures JGTRRA's reductions in the tax rate on dividends. Reference law used for the FY 2005 Budget includes capital gains as tax expenditure, but only to the extent capital gains have not previously been taxed under the corporate income tax. Similarly, the lower tax rate on dividends is not included as a tax expenditure under reference law because dividends have generally already been taxed under the corporate income tax. This exception was made as part of Treasury's ongoing reevaluation of the tax expenditure concept and to consider gradually changes in the baseline tax system to conform more closely with a comprehensive income tax that excludes double tax on corporate income. The same treatment is extended to the tax rate differential applied to capital gains on corporate shares, including JGTRRA's increase in this differential.

Performance Measures and the Economic Effects of Tax Expenditures

The Government Performance and Results Act of 1993 (GPRA) directs Federal agencies to develop annual and strategic plans for their programs and activities. These plans set out performance objectives to be achieved over a specific time period. Most of these objectives will be achieved through direct expenditure programs. Tax expenditures, however, may also contribute to achieving these goals. The report of the Senate Governmental Affairs Committee on GPRA[3] calls on the Executive branch to undertake a series of analyses to assess the effect of specific tax expenditures on the achievement of agencies' performance objectives.

The Executive Branch is continuing to focus on the availability of data needed to assess the effects of the tax expenditures designed to increase savings. Treasury's Office of Tax Analysis and Statistics of Income Division (IRS) have developed a new sample of individual income tax filers as one part of this effort. This new "panel" sample will follow the same taxpayers over a period of at least ten years. The first year of this panel sample was drawn from tax returns filed in 2000 for tax year 1999. The sample will capture the changing demographic and economic circumstances of individuals and the effects of changes in tax law over an extended period of time. Data from the sample will therefore permit more extensive, and better, analyses of many tax provisions than can be performed using only annual ("cross-section") data. In particular, data from this panel sample will enhance our ability to analyze the

[1] Gross income does, however, include transfer payments associated with past employment, such as Social Security benefits.

[2] In the case of individuals who hold "passive" equity interests in businesses, however, the pro-rata shares of sales and expense deductions reportable in a year are limited. A passive business activity is defined to be one in which the holder of the interest, usually a partnership interest, does not actively perform managerial or other participatory functions. The taxpayer may generally report no larger deductions for a year than will reduce taxable income from such activities to zero. Deductions in excess of the limitation may be taken in subsequent years, or when the interest is liquidated. In addition, costs of earning income may be limited under the alternative minimum tax.

[3] Committee on Government Affairs, United States Senate, "Government Performance and Results Act of 1993" (Report 103–58, 1993).

effect of tax expenditures designed to increase savings. Other efforts by OMB, Treasury, and other agencies to improve data available for the analysis of savings tax expenditures will continue over the next several years.

Comparison of tax expenditure, spending, and regulatory policies. Tax expenditures by definition work through the tax system and, particularly, the income tax. Thus, they may be relatively advantageous policy approaches when the benefit or incentive is related to income and is intended to be widely available.[4] Because there is an existing public administrative and private compliance structure for the tax system, the incremental administrative and compliance costs for a tax expenditure may be low in many cases. In addition, some tax expenditures actually simplify the tax system, (for example, the exclusion for up to $500,000 of capital gains on home sales). Tax expenditures also implicitly subsidize certain activities. Spending, regulatory or tax-disincentive policies can also modify behavior, but may have different economic effects. Finally, a variety of tax expenditure tools can be used—e.g., deductions; credits; exemptions; deferrals; floors; ceilings; phase-ins; phase-outs; dependent on income, expenses, or demographic characteristics (age, number of family members, etc.). This wide range means that tax expenditures can be flexible and can have very different economic effects.

Tax expenditures also have limitations. In many cases they add to the complexity of the tax system, which raises both administrative and compliance costs. For example, targeting personal exemptions and credits can complicate filing and decisionmaking. The income tax system may have little or no contact with persons who have no or very low incomes, and does not require information on certain characteristics of individuals used in some spending programs, such as wealth. These features may reduce the effectiveness of tax expenditures for addressing certain income-transfer objectives. Tax expenditures also generally do not enable the same degree of agency discretion as an outlay program. For example, grant or direct Federal service delivery programs can prioritize activities to be addressed with specific resources in a way that is difficult to emulate with tax expenditures. Finally, tax expenditures may not receive the same level of scrutiny afforded to other programs.

Outlay programs have advantages where direct Government service provision is particularly warranted—such as equipping and providing the armed forces or administering the system of justice. Outlay programs may also be specifically designed to meet the needs of low-income families who would not otherwise be subject to income taxes or need to file a tax return. Outlay programs may also receive more year-to-year oversight and fine tuning, through the legislative and executive budget process. In addition, many different types of spending programs—including direct Government provision; credit programs; and payments to State and local governments, the private sector, or individuals in the form of grants or contracts—provide flexibility for policy design. On the other hand, certain outlay programs—such as direct Government service provision—may rely less directly on economic incentives and private-market provision than tax incentives, which may reduce the relative efficiency of spending programs for some goals. Spending programs also require resources to be raised via taxes, user charges, or Government borrowing, which can impose further costs by diverting resources from their most efficient uses. Finally, spending programs, particularly on the discretionary side, may respond less readily to changing activity levels and economic conditions than tax expenditures.

Regulations have more direct and immediate effects than outlay and tax-expenditure programs because regulations apply directly and immediately to the regulated party (i.e., the intended actor)—generally in the private sector. Regulations can also be fine-tuned more quickly than tax expenditures, because they can generally be changed by the executive branch without legislation. Like tax expenditures, regulations often rely largely upon voluntary compliance, rather than detailed inspections and policing. As such, the public administrative costs tend to be modest, relative to the private resource costs associated with modifying activities. Historically, regulations have tended to rely on proscriptive measures, as opposed to economic incentives. This reliance can diminish their economic efficiency, although this feature can also promote full compliance where (as in certain safety-related cases) policymakers believe that trade-offs with economic considerations are not of paramount importance. Also, regulations generally do not directly affect Federal outlays or receipts. Thus, like tax expenditures, they may escape the type of scrutiny that outlay programs receive. However, major regulations are subjected to a formal regulatory analysis that goes well beyond the analysis required for outlays and tax-expenditures. To some extent, the GPRA requirement for performance evaluation will address this lack of formal analysis.

Some policy objectives are achieved using multiple approaches. For example, minimum wage legislation, the earned income tax credit, and the food stamp program are regulatory, tax expenditure, and direct outlay programs, respectively, all having the objective of improving the economic welfare of low-wage workers.

Tax expenditures, like spending and regulatory programs, have a variety of objectives and effects. These include: encouraging certain types of activities (e.g., saving for retirement or investing in certain sectors); increasing certain types of after-tax income (e.g., favorable tax treatment of Social Security income); reducing private compliance costs and Government administrative costs (e.g., the exclusion for up to $500,000 of capital gains on home sales); and promoting tax neutrality (e.g., accelerated depreciation in the presence of inflation). Some of these objectives are well suited to quantitative measurement, while others are less well suited.

[4] Although this section focuses upon tax expenditures under the income tax, tax expenditures also arise under the unified transfer, payroll, and excise tax systems. Such provisions can be useful when they relate to the base of those taxes, such as an excise tax exemption for certain types of consumption deemed meritorious.

Also, many tax expenditures, including those cited above, may have more than one objective. For example, accelerated depreciation may encourage investment. In addition, the economic effects of particular provisions can extend beyond their intended objectives (e.g., a provision intended to promote an activity or raise certain incomes may have positive or negative effects on tax neutrality).

Performance measurement is generally concerned with inputs, outputs, and outcomes. In the case of tax expenditures, the principal input is usually the revenue effect. Outputs are quantitative or qualitative measures of goods and services, or changes in income and investment, directly produced by these inputs. Outcomes, in turn, represent the changes in the economy, society, or environment that are the ultimate goals of programs.

Thus, for a provision that reduces taxes on certain investment activity, an increase in the amount of investment would likely be a key output. The resulting production from that investment, and, in turn, the associated improvements in national income, welfare, or security, could be the outcomes of interest. For other provisions, such as those designed to address a potential inequity or unintended consequence in the tax code, an important performance measure might be how they change effective tax rates (the discounted present-value of taxes owed on new investments or incremental earnings) or excess burden (an economic measure of the distortions caused by taxes). Effects on the incomes of members of particular groups may be an important measure for certain provisions.

An overview of evaluation issues by budget function. The discussion below considers the types of measures that might be useful for some major programmatic groups of tax expenditures. The discussion is intended to be illustrative and not all encompassing. However, it is premised on the assumption that the data needed to perform the analysis are available or can be developed. In practice, data availability is likely to be a major challenge, and data constraints may limit the assessment of the effectiveness of many provisions. In addition, such assessments can raise significant challenges in economic modeling.

National defense.—Some tax expenditures are intended to assist governmental activities. For example, tax preferences for military benefits reflect, among other things, the view that benefits such as housing, subsistence, and moving expenses are intrinsic aspects of military service, and are provided, in part, for the benefit of the employer, the U.S. Government. Tax benefits for combat service are intended to reduce tax burdens on military personnel undertaking hazardous service for the Nation. A portion of the tax expenditure associated with foreign earnings is targeted to benefit U.S. Government civilian personnel working abroad by offsetting the living costs that can be higher than those in the United States. These tax expenditures should be considered together with direct agency budget costs in making programmatic decisions.

International affairs.—Tax expenditures are also aimed at goals such as tax neutrality. These include the exclusion for income earned abroad by nongovernmental employees and exclusions for income of U.S.-controlled foreign corporations. Measuring the effectiveness of these provisions raises challenging issues.

General science, space and technology; energy; natural resources and the environment; agriculture; and commerce and housing.—A series of tax expenditures reduces the cost of investment, both in specific activities—such as research and experimentation, extractive industries, and certain financial activities—and more generally, through accelerated depreciation for plant and equipment. These provisions can be evaluated along a number of dimensions. For example, it could be useful to consider the strength of the incentives by measuring their effects on the cost of capital (the interest rate which investments must yield to cover their costs) and effective tax rates. The impact of these provisions on the amounts of corresponding forms of investment (e.g., research spending, exploration activity, equipment) might also be estimated. In some cases, such as research, there is evidence that the investment can provide significant positive externalities—that is, economic benefits that are not reflected in the market transactions between private parties. It could be useful to quantify these externalities and compare them with the size of tax expenditures. Measures could also indicate the effects on production from these investments—such as numbers or values of patents, energy production and reserves, and industrial production. Issues to be considered include the extent to which the preferences increase production (as opposed to benefitting existing output) and their cost-effectiveness relative to other policies. Analysis could also consider objectives that are more difficult to measure but still are ultimate goals, such as promoting the Nation's technological base, energy security, environmental quality, or economic growth. Such an assessment is likely to involve tax analysis as well as consideration of non-tax matters such as market structure, scientific, and other information (such as the effects of increased domestic fuel production on imports from various regions, or the effects of various energy sources on the environment).

Housing investment also benefits from tax expenditures. The mortgage interest deduction on personal residences is reported as a tax expenditure because the value of owner-occupied housing services is not included in a taxpayer's taxable income. Taxpayers also may exclude up to $500,000 of the capital gains from the sale of personal residences. Measures of the effectiveness of these provisions could include their effects on increasing the extent of home ownership and the quality of housing.. Similarly, analysis of the extent of accumulated inflationary gains is likely to be relevant to evaluation of the capital gains for home sales. Deductibility of State and local property taxes assists with making housing more affordable as well as easing the cost of providing community services through these taxes. Provisions intended to promote investment in rental housing could be evaluated for their effects on making such housing more available and affordable. These provisions should then be compared with alternative programs that address housing supply and demand.

Transportation.—Employer-provided parking is a fringe benefit that, for the most part, is excluded from taxation. The tax expenditure estimates reflect the cost of parking that is leased by employers for employees; an estimate is not currently available for the value of parking owned by employers and provided to their employees. The exclusion for employer-provided transit passes is intended to promote use of this mode of transportation, which has environmental and congestion benefits. The tax treatments of these different benefits could be compared with alternative transportation policies.

Community and regional development.—A series of tax expenditures is intended to promote community and regional development by reducing the costs of financing specialized infrastructure, such as airports, docks, and stadiums. Empowerment zone and enterprise community provisions are designed to promote activity in disadvantaged areas. These provisions can be compared with grants and other policies designed to spur economic development.

Education, training, employment, and social services.—Major provisions in this function are intended to promote post-secondary education, to offset costs of raising children, and to promote a variety of charitable activities. The education incentives can be compared with loans, grants, and other programs designed to promote higher education and training. The child credits are intended to adjust the tax system for the costs of raising children; as such, they could be compared to other Federal tax and spending policies, including related features of the tax system, such as personal exemptions (which are not defined as a tax expenditure). Evaluation of charitable activities requires consideration of the beneficiaries of these activities, who are generally not the parties receiving the tax reduction.

Health.—Individuals also benefit from favorable treatment of employer-provided health insurance. Measures of these benefits could include increased coverage and pooling of risks. The effects of insurance coverage on final outcome measures of actual health (e.g., infant mortality, days of work lost due to illness, or life expectancy) or intermediate outcomes (e.g., use of preventive health care or health care costs) could also be investigated.

Income security, Social Security, and veterans benefits and services.—Major tax expenditures in the income security function benefit retirement savings, through employer-provided pensions, individual retirement accounts, and Keogh plans. These provisions might be evaluated in terms of their effects on boosting retirement incomes, private savings, and national savings (which would include the effect on private savings as well as public savings or deficits). Interactions with other programs, including Social Security, also may merit analysis. As in the case of employer-provided health insurance, analysis of employer-provided pension programs requires imputing the value of benefits funded at the firm level to individuals.

Other provisions principally affect the incomes of members of certain groups, rather than affecting incentives. For example, tax-favored treatment of Social Security benefits, certain veterans benefits, and deductions for the blind and elderly provide increased incomes to eligible parties. The earned-income tax credit, in contrast, should be evaluated for its effects on labor force participation as well as the income it provides lower-income workers.

General purpose fiscal assistance and interest.—The tax-exemption for public purpose State and local bonds reduces the costs of borrowing for a variety of purposes (borrowing for non-public purposes is reflected under other budget functions). The deductibility of certain State and local taxes reflected under this function primarily relates to personal income taxes (property tax deductibility is reflected under the commerce and housing function). Tax preferences for Puerto Rico and other U.S. possessions are also included here. These provisions can be compared with other tax and spending policies as means of benefitting fiscal and economic conditions in the States, localities, and possessions. Finally, the tax deferral for interest on U.S. savings bonds benefits savers who invest in these instruments. The extent of these benefits and any effects on Federal borrowing costs could be evaluated.

The above illustrative discussion, although broad, is nevertheless incomplete, omitting important details both for the provisions mentioned and the many that are not explicitly cited. Developing a framework that is sufficiently comprehensive, accurate, and flexible to reflect the objectives and effects of the wide range of tax expenditures will be a significant challenge. OMB, Treasury, and other agencies will work together, as appropriate, to address this challenge. As indicated above, over the next few years the Executive Branch's focus will be on the availability of the data needed to assess the effects of the tax expenditures designed to increase savings.

Descriptions of Income Tax Provisions

Descriptions of the individual and corporate income tax expenditures reported upon in this chapter follow. These descriptions relate to current law as of December 31, 2003, and do not reflect proposals made elsewhere in the Budget.

National Defense

1. ***Benefits and allowances to armed forces personnel.***—The housing and meals provided military personnel, either in cash or in kind, as well as certain amounts of pay related to combat service, are excluded from income subject to tax.

International Affairs

2. ***Income earned abroad.***— U.S. citizens who lived abroad, worked in the private sector, and satisfied a foreign residency requirement in 2001 may exclude up to $78,000 in foreign earned income from U.S. taxes. The exclusion increases to $80,000 in 2002 (and thereafter). In addition, if these taxpayers receive a specific allowance for foreign housing from their employers, they may also exclude the value of that allowance. If they do not receive a specific allowance for housing expenses, they may deduct against their U.S. taxes that portion of such expenses that exceeds one-sixth the salary of a civil servant at grade GS-14, step 1 ($72,381 in 2003).

3. ***Exclusion of certain allowances for Federal employees abroad.***—U.S. Federal civilian employees and Peace Corps members who work outside the continental United States are allowed to exclude from U.S. taxable income certain special allowances they receive to compensate them for the relatively high costs associated with living overseas. The allowances supplement wage income and cover expenses like rent, education, and the cost of travel to and from the United States.

4. ***Extraterritorial income exclusion.***[5]—For purposes of calculating U.S. tax liability, a taxpayer may exclude from gross income the qualifying foreign trade income attributable to foreign trading gross receipts. The exclusion generally applies to income from the sale or lease of qualifying foreign trade property and certain types of services income. The FSC Repeal and Extraterritorial Income Exclusion Act of 2000 created the extraterritorial income exclusion to replace the foreign sales corporation provisions, which the Act repealed. The exclusion is generally available for transactions entered into after September 30, 2000.

5. ***Sales source rule exceptions.***—The worldwide income of U.S. persons is taxable by the United States and a credit for foreign taxes paid is allowed. The amount of foreign taxes that can be credited is limited to the pre-credit U.S. tax on the foreign source income. The sales source rules for inventory property allow U.S. exporters to use more foreign tax credits by allowing the exporters to attribute a larger portion of their earnings abroad than would be the case if the allocation of earnings was based on actual economic activity.

6. ***Income of U.S.-controlled foreign corporations.***—The income of foreign corporations controlled by U.S. shareholders is not subject to U.S. taxation. The income becomes taxable only when the controlling U.S. shareholders receive dividends or other distributions from their foreign stockholding. Under the normal tax method, the currently attributable foreign source pre-tax income from such a controlling interest is considered to be subject to U.S. taxation, whether or not distributed. Thus, the normal tax method considers the amount of controlled foreign corporation income not yet distributed to a U.S. shareholder as tax-deferred income.

7. ***Exceptions under subpart F for active financing income.***—Financial firms can defer taxes on income earned overseas in an active business. Taxes on income earned through December 31, 2006 can be deferred.

General Science, Space, and Technology

8. ***Expensing R&E expenditures.***—Research and experimentation (R&E) projects can be viewed as investments because, if successful, their benefits accrue for several years. It is often difficult, however, to identify whether a specific R&E project is successful and, if successful, what its expected life will be. Under the normal tax method, the expensing of R&E expenditures is viewed as a tax expenditure. The baseline assumed for the normal tax method is that all R&E expenditures are successful and have an expected life of five years.

9. ***R&E credit.***—The research and experimentation (R&E) credit is 20 percent of qualified research expenditures in excess of a base amount. The base amount is generally determined by multiplying a “fixed-base percentage” by the average amount of the company’s gross receipts for the prior four years. The taxpayer’s fixed base percentage generally is the ratio of its research expenses to gross receipts for 1984 through 1988. Taxpayers may also elect an alternative credit regime. Under the alternative credit regime the taxpayer is assigned a three-tiered fixed-base percentage that is lower than the fixed-base percentage that would otherwise apply, and the credit rate is reduced (the rates range from 2.65 percent to 3.75 percent). A 20-percent credit with a separate threshold is provided for a taxpayer’s payments to universities for basic research. The credit applies to research conducted before July 1, 2004 and extends to research conducted in Puerto Rico and the U.S. possessions.

Energy

10. ***Exploration and development costs.***—For successful investments in domestic oil and gas wells, intangible drilling costs (e.g., wages, the costs of using machinery for grading and drilling, the cost of unsalvageable materials used in constructing wells) may be expensed rather than amortized over the productive life of the property. Integrated oil companies may deduct only 70 percent of such costs and must amortize the remaining 30 percent over five years. The same rule applies to the exploration and development costs of surface stripping and the construction of shafts and tunnels for other fuel minerals.

11. ***Percentage depletion.***—Independent fuel mineral producers and royalty owners are generally allowed to take percentage depletion deductions rather than cost depletion on limited quantities of output. Under cost depletion, outlays are deducted over the productive life of the property based on the fraction of the resource extracted. Under percentage depletion, taxpayers de-

[5] The determination of whether a provision is a tax expenditure is made on the basis of a broad concept of “income” that is larger in scope than is “income” as defined under general U.S. income tax principles. For that reason, the tax expenditure estimates include, for example, estimates related to the exclusion of extraterritorial income, as well as other exclusions, notwithstanding that such exclusions define income under the general rule of U.S. income taxation.

duct a percentage of gross income from mineral production at rates of 22 percent for uranium; 15 percent for oil, gas and oil shale; and 10 percent for coal. The deduction is limited to 50 percent of net income from the property, except for oil and gas where the deduction can be 100 percent of net property income. Production from geothermal deposits is eligible for percentage depletion at 65 percent of net income, but with no limit on output and no limitation with respect to qualified producers. Unlike depreciation or cost depletion, percentage depletion deductions can exceed the cost of the investment.

12. ***Alternative fuel production credit.***—A nontaxable credit of $3 per oil-equivalent barrel of production (in 1979 dollars) is provided for several forms of alternative fuels. The credit is generally available if the price of oil stays below $29.50 (in 1979 dollars). The credit generally expires on December 31, 2002.

13. ***Oil and gas exception to passive loss limitation.***—Owners of working interests in oil and gas properties are exempt from the "passive income" limitations. As a result, the working interest-holder, who manages on behalf of himself and all other owners the development of wells and incurs all the costs of their operation, may aggregate negative taxable income from such interests with his income from all other sources.

14. ***Capital gains treatment of royalties on coal.***—Sales of certain coal under royalty contracts can be treated as capital gains rather than ordinary income.

15. ***Energy facility bonds.***—Interest earned on State and local bonds used to finance construction of certain energy facilities is tax-exempt. These bonds are generally subject to the State private-activity bond annual volume cap.

16. ***Enhanced oil recovery credit.***—A credit is provided equal to 15 percent of the taxpayer's costs for tertiary oil recovery on U.S. projects. Qualifying costs include tertiary injectant expenses, intangible drilling and development costs on a qualified enhanced oil recovery project, and amounts incurred for tangible depreciable property.

17. ***New technology credits.***—A credit of 10 percent is available for investment in solar and geothermal energy facilities. In addition, a credit of 1.5 cents is provided per kilowatt hour of electricity produced from renewable resources such as wind, biomass, and poultry waste facilities. The renewable resources credit applies only to electricity produced by a facility placed in service on or before December 31, 2004.

18. ***Alcohol fuel credits.***—An income tax credit is provided for ethanol that is derived from renewable sources and used as fuel. The credit equals 53 cents per gallon in 2001 and 2002; 52 cents per gallon in 2003 and 2004; and 51 cents per gallon in 2005, 2006, and 2007. To the extent that ethanol is mixed with taxable motor fuel to create gasohol, taxpayers may claim an exemption of the Federal excise tax rather than the income tax credit. In addition, small ethanol producers are eligible for a separate 10 cents per gallon credit.

19. ***Credit and deduction for clean-fuel vehicles and property.***—A tax credit of 10 percent (not to exceed $4,000) is provided for purchasers of electric vehicles. Purchasers of other clean-fuel burning vehicles and owners of clean-fuel refueling property may deduct part of their expenditures. The credit and deduction are phased out from 2004 through 2007,.

20. ***Exclusion of utility conservation subsidies.***—Non-business customers can exclude from gross income subsidies received from public utilities for expenditures on energy conservation measures.

Natural Resources and Environment

21. ***Exploration and development costs.***—Certain capital outlays associated with exploration and development of nonfuel minerals may be expensed rather than depreciated over the life of the asset.

22. ***Percentage depletion.***—Most nonfuel mineral extractors may use percentage depletion rather than cost depletion, with percentage depletion rates ranging from 22 percent for sulfur to 5 percent for sand and gravel.

23. Sewage, water, solid and hazardous waste facility bonds.—Interest earned on State and local bonds used to finance the construction of sewage, water, or hazardous waste facilities is tax-exempt. These bonds are generally subject to the State private-activity bond annual volume cap.

24. ***Capital gains treatment of certain timber.***—Certain timber sold under a royalty contract can be treated as a capital gain rather than ordinary income.

25. ***Expensing multiperiod timber growing costs.***—Most of the production costs of growing timber may be expensed rather than capitalized and deducted when the timber is sold. In most other industries, these costs are capitalized under the uniform capitalization rules.

26. ***Historic preservation.***—Expenditures to preserve and restore historic structures qualify for a 20-percent investment credit, but the depreciable basis must be reduced by the full amount of the credit taken.

Agriculture

27. ***Expensing certain capital outlays.***—Farmers, except for certain agricultural corporations and partnerships, are allowed to expense certain expenditures for feed and fertilizer, as well as for soil and water conservation measures. Expensing is allowed, even though these expenditures are for inventories held beyond the end of the year, or for capital improvements that would otherwise be capitalized.

28. ***Expensing multiperiod livestock and crop production costs.***—The production of livestock and crops with a production period of less than two years is exempt from the uniform cost capitalization rules. Farmers establishing orchards, constructing farm facilities for their own use, or producing any goods for sale with a production period of two years or more may elect not to capitalize costs. If they do, they must apply

straight-line depreciation to all depreciable property they use in farming.

29. ***Loans forgiven solvent farmers.***—Farmers are forgiven the tax liability on certain forgiven debt. Normally, debtors must include the amount of loan forgiveness as income or reduce their recoverable basis in the property to which the loan relates. If the debtor elects to reduce basis and the amount of forgiveness exceeds the basis in the property, the excess forgiveness is taxable. For insolvent (bankrupt) debtors, however, the amount of loan forgiveness reduces carryover losses, then unused credits, and then basis; any remainder of the forgiven debt is excluded from tax. Farmers with forgiven debt are considered insolvent for tax purposes, and thus qualify for income tax forgiveness.

30. ***Capital gains treatment of certain income.***—Certain agricultural income, such as unharvested crops, can be treated as capital gains rather than ordinary income.

31. ***Income averaging for farmers.***—Taxpayers can lower their tax liability by averaging, over the prior three-year period, their taxable income from farming.

32. ***Deferral of gain on sales of farm refiners.***—A taxpayer who sells stock in a farm refiner to a farmers' cooperative can defer recognition of gain if the taxpayer reinvests the proceeds in qualified replacement property.

Commerce and Housing

This category includes a number of tax expenditure provisions that also affect economic activity in other functional categories. For example, provisions related to investment, such as accelerated depreciation, could be classified under the energy, natural resources and environment, agriculture, or transportation categories.

33. ***Credit union income.***—The earnings of credit unions not distributed to members as interest or dividends are exempt from income tax.

34. ***Bad debt reserves.***—Small (less than $500 million in assets) commercial banks, mutual savings banks, and savings and loan associations may deduct additions to bad debt reserves in excess of actually experienced losses.

35. ***Deferral of income on life insurance and annuity contracts.***—Favorable tax treatment is provided for investment income within qualified life insurance and annuity contracts. Investment income earned on qualified life insurance contracts held until death is permanently exempt from income tax. Investment income distributed prior to the death of the insured is tax-deferred, if not tax-exempt. Investment income earned on annuities is treated less favorably than income earned on life insurance contracts, but it benefits from tax deferral without annual contribution or income limits generally applicable to other tax-favored retirement income plans.

36. ***Small property and casualty insurance companies.***— Insurance companies that have annual net premium incomes of less than $350,000 are exempt from tax; those with $350,000 to $2.1 million of net premium incomes may elect to pay tax only on the income earned by their investment portfolio.

37. ***Insurance companies owned by exempt organizations.***—Generally, the income generated by life and property and casualty insurance companies is subject to tax, albeit by special rules. Insurance operations conducted by such exempt organizations as fraternal societies and voluntary employee benefit associations, however, are exempt from tax.

38. ***Small life insurance company deduction.***—Small life insurance companies (gross assets of less than $500 million) can deduct 60 percent of the first $3 million of otherwise taxable income. The deduction phases out for otherwise taxable income between $3 million and $15 million.

39. ***Mortgage housing bonds.***—Interest earned on State and local bonds used to finance homes purchased by first-time, low-to-moderate-income buyers is tax-exempt. The amount of State and local tax-exempt bonds that can be issued to finance these and other private activity is limited. The combined volume cap for private activity bonds, including mortgage housing bonds, rental housing bonds, student loan bonds, and industrial development bonds was $62.50 per capita ($187.5 million minimum) per State in 2001, and $75 per capita ($225 million minimum) in 2002. The Community Renewal Tax Relief Act of 2000 accelerated the scheduled increase in the state volume cap and indexed the cap for inflation, beginning in 2003. States may issue mortgage credit certificates (MCCs) in lieu of mortgage revenue bonds. MCCs entitle home buyers to income tax credits for a specified percentage of interest on qualified mortgages. The total amount of MCCs issued by a State cannot exceed 25 percent of its annual ceiling for mortgage-revenue bonds.

40. ***Rental housing bonds.***—Interest earned on State and local government bonds used to finance multifamily rental housing projects is tax-exempt. At least 20 percent (15 percent in targeted areas) of the units must be reserved for families whose income does not exceed 50 percent of the area's median income; or 40 percent for families with incomes of no more than 60 percent of the area median income. Other tax-exempt bonds for multifamily rental projects are generally issued with the requirement that all tenants must be low or moderate income families. Rental housing bonds are subject to the volume cap discussed in the mortgage housing bond section above.

41. ***Interest on owner-occupied homes.***—Owner-occupants of homes may deduct mortgage interest on their primary and secondary residences as itemized nonbusiness deductions. The mortgage interest deduction is limited to interest on debt no greater than the owner's basis in the residence and, for debt incurred

after October 13, 1987, it is limited to no more than $1 million. Interest on up to $100,000 of other debt secured by a lien on a principal or second residence is also deductible, irrespective of the purpose of borrowing, provided the debt does not exceed the fair market value of the residence. Mortgage interest deductions on personal residences are tax expenditures because the value of owner-occupied housing services is not included in a taxpayer's taxable income. The Appendix provides an alternative calculation of the tax expenditure based on the implicit rental income on owner-occupied housing, which is generally viewed as a more accurate measure of the tax expenditure relative to a comprehensive income tax base.

42. ***Taxes on owner-occupied homes.***—Owner-occupants of homes may deduct property taxes on their primary and secondary residences even though they are not required to report the value of owner-occupied housing services as gross income.

43. ***Installment sales.***—Dealers in real and personal property (i.e., sellers who regularly hold property for sale or resale) cannot defer taxable income from installment sales until the receipt of the loan repayment. Nondealers (i.e., sellers of real property used in their business) are required to pay interest on deferred taxes attributable to their total installment obligations in excess of $5 million. Only properties with sales prices exceeding $150,000 are includable in the total. The payment of a market rate of interest eliminates the benefit of the tax deferral. The tax exemption for nondealers with total installment obligations of less than $5 million is, therefore, a tax expenditure.

44. ***Capital gains exclusion on home sales.***—A homeowner can exclude from tax up to $500,000 ($250,000 for singles) of the capital gains from the sale of a principal residence. The exclusion may not be used more than once every two years.

45. ***Passive loss real estate exemption.***—In general, passive losses may not offset income from other sources. Losses up to $25,000 attributable to certain rental real estate activity, however, are exempt from this rule.

46. ***Low-income housing credit.***—Taxpayers who invest in certain low-income housing are eligible for a tax credit. The credit rate is set so that the present value of the credit is equal to 70 percent for new construction and 30 percent for (1) housing receiving other Federal benefits (such as tax-exempt bond financing), or (2) substantially rehabilitated existing housing. The credit is allowed in equal amounts over 10 years. State agencies determine who receives the credit; States are limited in the amount of credit they may authorize annually. The Community Renewal Tax Relief Act of 2000 increased the per-resident limit to $1.50 in 2001 and to $1.75 in 2002 and indexed the limit for inflation, beginning in 2003. The Act also created a $2 million minimum annual cap for small States beginning in 2002; the cap is indexed for inflation, beginning in 2003.

47. ***Accelerated depreciation of rental property.***—The tax depreciation allowance provisions are part of the reference law rules, and thus do not give rise to tax expenditures under the reference method. Under the normal tax method, however, economic depreciation is assumed. This calculation is described in more detail in the Appendix.

48. ***Cancellation of indebtedness.***—Individuals are not required to report the cancellation of certain indebtedness as current income. If the canceled debt is not reported as current income, however, the basis of the underlying property must be reduced by the amount canceled.

49. ***Imputed interest rules.***—Holders (issuers) of debt instruments are generally required to report interest earned (paid) in the period it accrues, not when paid. In addition, the amount of interest accrued is determined by the actual price paid, not by the stated principal and interest stipulated in the instrument. In general, any debt associated with the sale of property worth less than $250,000 is excepted from the general interest accounting rules. This general $250,000 exception is not a tax expenditure under reference law but is under normal law. Exceptions above $250,000 are a tax expenditure under reference law; these exceptions include the following: (1) sales of personal residences worth more than $250,000, and (2) sales of farms and small businesses worth between $250,000 and $1 million.

50. ***Capital gains (other than agriculture, timber, iron ore, and coal).***—Capital gains on assets held for more than 1 year are taxed at a lower rate than ordinary income. Under the revised reference law baseline used for the FY 2005 Budget, the lower rate on capital gains is considered a tax expenditure under the reference law method, but only for capital gains that have not been previously taxed under the corporate income tax. As discussed above, this treatment excludes the double tax on corporate income and is more consistent with a comprehensive income tax base.

Prior to passage of the Jobs Growth Tax Relief Reconciliation Act (JGTRRA), the top capital gains tax rate for most assets held for more than 1 year was 20 percent. For assets acquired after December 31, 2000, the top capital gains tax rate for assets held for more than 5 years was 18 percent. Since January 1, 2001, taxpayers may mark-to-market existing assets to start the 5-year holding period. Losses from the mark-to-market are not recognized.

For assets held for more than 1 year by taxpayers in the 15-percent ordinary tax bracket, the top capital gains tax rate was 10 percent. After December 31, 2000, the top capital gains tax rate for assets held by these taxpayers for more than 5 years was 8 percent.

JGTRRA reduced the previous 20 percent and 18 percent rates on net capital gains to 15 percent and the previous 10 percent and 8 percent rates to 5 percent (0 percent, in 2008). The lower rates apply to assets held for more than one year. The lower rates apply to assets sold after May 6, 2003 through 2008.

51. ***Capital gains exclusion for small business stock.***—An exclusion of 50 percent is provided for capital gains from qualified small business stock held by individuals for more than 5 years. A qualified small business is a corporation whose gross assets do not exceed $50 million as of the date of issuance of the stock.

52. ***Step-up in basis of capital gains at death.***—Capital gains on assets held at the owner's death are not subject to capital gains taxes. The cost basis of the appreciated assets is adjusted upward to the market value at the owner's date of death. After repeal of the estate tax for 2010 under the Economic Growth and Tax Relief Reconciliation Act (EGTRRA) of 2001, the basis for property acquired from a decedent will be the lesser of fair market value or the decedent's basis. Certain types of additions to basis will be allowed so that assets in most estates that are not currently subject to estate tax will not be subject to capital gains tax in the hands of the heirs.

53. ***Carryover basis of capital gains on gifts.***—When a gift is made, the donor's basis in the transferred property (the cost that was incurred when the transferred property was first acquired) carries-over to the donee. The carryover of the donor's basis allows a continued deferral of unrealized capital gains. Even though the estate tax is repealed for 2010 under EGTRRA, the gift tax is retained with a lifetime exemption of $1 million.

54. ***Ordinary income treatment of losses from sale of small business corporate stock shares.***—Up to $100,000 in losses from the sale of small business corporate stock (capitalization less than $1 million) may be treated as ordinary losses. Such losses would, thus, not be subject to the $3,000 annual capital loss write-off limit.

55. ***Accelerated depreciation of non-rental-housing buildings.***—The tax depreciation allowance provisions are part of the reference law rules, and thus do not give rise to tax expenditures under reference law. Under normal law, however, economic depreciation is assumed. This calculation is described in more detail in the Appendix.

56. ***Accelerated depreciation of machinery and equipment.***—The tax depreciation allowance provisions are part of the reference law rules, and thus do not give rise to tax expenditures under reference law. Under the normal tax baseline, this tax depreciation allowance is measured relative to economic depreciation. This calculation is described in more detail in the Appendix.

57. ***Expensing of certain small investments.***—In 2002, qualifying investments in tangible property up to $24,000 could be expensed rather than depreciated over time. The expensing limit increases to $25,000 in 2003. To the extent that qualifying investment during the year exceeds $200,000, the amount eligible for expensing is decreased. In 2002, the amount expensed was completely phased out when qualifying investments exceeded $224,000.

58. ***Business start-up costs.***—When taxpayers enter into a new business, certain start-up expenses, such as the cost of legal services, are normally incurred. Taxpayers may elect to amortize these outlays over 60 months even though they are similar to other payments made for nondepreciable intangible assets that are not recoverable until the business is sold. The normal tax method treats this amortization as a tax expenditure; the reference tax method does not.

59. ***Graduated corporation income tax rate schedule.***—The corporate income tax schedule is graduated, with rates of 15 percent on the first $50,000 of taxable income, 25 percent on the next $25,000, and 34 percent on the next $9.925 million. Compared with a flat 34-percent rate, the lower rates provide an $11,750 reduction in tax liability for corporations with taxable income of $75,000. This benefit is recaptured for corporations with taxable incomes exceeding $100,000 by a 5-percent additional tax on corporate incomes in excess of $100,000 but less than $335,000.

The corporate tax rate is 35 percent on income over $10 million. Compared with a flat 35-percent tax rate, the 34-percent rate provides a $100,000 reduction in tax liability for corporations with taxable incomes of $10 million. This benefit is recaptured for corporations with taxable incomes exceeding $15 million by a 3-percent additional tax on income over $15 million but less than $18.33 million. Because the corporate rate schedule is part of reference tax law, it is not considered a tax expenditure under the reference method. A flat corporation income tax rate is taken as the baseline under the normal tax method; therefore the lower rates is considered a tax expenditure under this concept.

60. ***Small issue industrial development bonds.***—Interest earned on small issue industrial development bonds (IDBs) issued by State and local governments to finance manufacturing facilities is tax-exempt. Depreciable property financed with small issue IDBs must be depreciated, however, using the straight-line method. The annual volume of small issue IDBs is subject to the unified volume cap discussed in the mortgage housing bond section above.

Transportation

61. ***Deferral of tax on U.S. shipping companies.***—Certain companies that operate U.S. flag vessels can defer income taxes on that portion of their income used for shipping purposes, primarily construction, modernization and major repairs to ships, and repayment of loans to finance these investments. Once indefinite, the deferral has been limited to 25 years since January 1, 1987.

62. ***Exclusion of employee parking expenses.***—Employee parking expenses that are paid for by the employer or that are received in lieu of wages are excludable from the income of the employee. Since 2002, the maximum amount of the parking exclusion is $185 (indexed) per month. The tax expenditure estimate does not include parking at facilities owned by the employer.

63. ***Exclusion of employee transit pass expenses.***—Transit passes, tokens, fare cards, and vanpool expenses paid for by an employer or provided in lieu of wages to defray an employee's commuting costs are excludable from the employee's income. Since 2002, the maximum amount of the exclusion is $100 (indexed) per month.

Community and Regional Development

64. ***Rehabilitation of structures.***—A 10-percent investment tax credit is available for the rehabilitation of buildings that are used for business or productive activities and that were erected before 1936 for other than residential purposes. The taxpayer's recoverable basis must be reduced by the amount of the credit.

65. ***Airport, dock, and similar facility bonds.***—Interest earned on State and local bonds issued to finance high-speed rail facilities and government-owned airports, docks, wharves, and sport and convention facilities is tax-exempt. These bonds are not subject to a volume cap.

66. ***Exemption of income of mutuals and cooperatives.***—The incomes of mutual and cooperative telephone and electric companies are exempt from tax if at least 85 percent of their revenues are derived from patron service charges.

67. ***Empowerment zones, enterprise communities, and renewal communities.***—Qualifying businesses in designated economically depressed areas can receive tax benefits such as an employer wage credit, increased expensing of investment in equipment, special tax-exempt financing, accelerated depreciation, and certain capital gains incentives. The Job Creation and Worker Assistance Act of 2002 expanded the existing provisions by adding the "New York City Liberty Zone." In addition, certain first-time buyers of a principal residence in the District of Columbia can receive a tax credit on homes purchased on or before December 31, 2003, and investors in certain D.C. property can receive a capital gains break. The Community Renewal Tax Relief Act of 2000 created the renewal communities tax benefits, which begin on January 1, 2002 and expires on December 31, 2009. The Act also created additional empowerment zones, increased the tax benefits for empowerment zones, and extended the expiration date of (1) empowerment zones from December 31, 2004 to December 31, 2009, and (2) the D.C. home-buyer credit from December 31, 2001 to December 31, 2003.

68. ***New markets tax credit.***—Taxpayers who invest in a community development entity (CDE) after December 31, 2000 are eligible for a tax credit. The total equity investment available for the credit across all CDEs is $1.0 billion in 2001, $1.5 billion in 2002 and 2003, $2.0 billion in 2004 and 2005, and $3.5 billion in 2006 and 2007. The amount of the credit equals (1) 5 percent in the year of purchase and the following 2 years, and (2) 6 percent in the following 4 years. A CDE is any domestic firm whose primary mission is to serve or provide investment capital for low-income communities/individuals; a CDE must be accountable to residents of low-income communities. The Community Renewal Tax Relief Act of 2000 created the new markets tax credit.

69. ***Expensing of environmental remediation costs.***—Taxpayers who clean up certain hazardous substances at a qualified site may expense the clean-up costs, rather than capitalize the costs, even though the expenses will generally increase the value of the property significantly or appreciably prolong the life of the property. The expensing only applies to clean-up costs incurred on or before December 31, 2003. The Community Renewal Tax Relief Act of 2000 extended the expiration date from December 31, 2001 to December 31, 2003. The Act also expanded the number of qualified sites.

Education, Training, Employment, and Social Services

70. ***Scholarship and fellowship income.***—Scholarships and fellowships are excluded from taxable income to the extent they pay for tuition and course-related expenses of the grantee. Similarly, tuition reductions for employees of educational institutions and their families are not included in taxable income. From an economic point of view, scholarships and fellowships are either gifts not conditioned on the performance of services, or they are rebates of educational costs. Thus, under the reference law method, this exclusion is not a tax expenditure because this method does not include either gifts or price reductions in a taxpayer's gross income. The exclusion, however, is considered a tax expenditure under the normal tax method, which includes gift-like transfers of Government funds in gross income (many scholarships are derived directly or indirectly from Government funding).

71. ***HOPE tax credit.***— The non-refundable HOPE tax credit allows a credit for 100 percent of an eligible student's first $1,000 of tuition and fees and 50 percent of the next $1,000 of tuition and fees. The credit only covers tuition and fees paid during the first two years of a student's post-secondary education. In 2003, the credit is phased out ratably for taxpayers with modified AGI between $83,000 and $103,000 ($41,000 and $51,000 for singles), indexed.

72. ***Lifetime Learning tax credit.***—The non-refundable Lifetime Learning tax credit allows a credit for 20 percent of an eligible student's tuition and fees. For tuition and fees paid after December 31, 2002, the maximum credit per return is $2,000. The credit is phased out ratably for taxpayers with modified AGI between $83,000 and $103,000 ($41,000 and $51,000 for singles) (indexed beginning in 2002). The credit applies to both undergraduate and graduate students.

73. ***Deduction for Higher Education Expenses.***—The maximum annual deduction for qualified higher education expenses is $3,000 in 2003 for taxpayers with adjusted gross income up to $130,000 on a joint return ($65,000 for singles). The maximum deduction increases to $4,000 in 2004. Taxpayers with adjusted gross income up to $160,000 on a joint return ($80,000 for

singles) may deduct up to $2,000 beginning in 2004. No deduction is allowed for expenses paid after December 31, 2005.

74. ***Education Individual Retirement Accounts.***—Contributions to an education IRA are not tax-deductible. Investment income earned by education IRAs is not taxed when earned, and investment income from an education IRA is tax-exempt when withdrawn to pay for a student's tuition and fees. The maximum contribution to an education IRA in 2003 is $200 per beneficiary. The maximum contribution is phased down ratably for taxpayers with modified AGI between $159,000 and $220,000 ($95,000 and $110,000 for singles). EGTRRA increases the maximum contribution to $2,000 and the phase-out range for joint filers to $190,000 through $220,000 of modified AGI, double the range of singles.

75. ***Student-loan interest.***—Taxpayers may claim an above-the-line deduction of up to $2,500 on interest paid on an education loan. Interest may only be deducted for the first five years in which interest payments are required. In 2003, the maximum deduction is phased down ratably for taxpayers with modified AGI between $100,000 and $130,000 ($50,000 and $65,000 for singles), indexed.

76. ***State prepaid tuition plans.***—Some States have adopted prepaid tuition plans and prepaid room and board plans, which allow persons to pay in advance for college expenses for designated beneficiaries. In 2001 taxes on the earnings from these plans are paid by the beneficiaries and are deferred until tuition is actually paid. Beginning in 2002, investment income is not taxed when earned, and is tax-exempt when withdrawn to pay for qualified expenses. These changes were the result of EGTRRA.

77. ***Student-loan bonds.***—Interest earned on State and local bonds issued to finance student loans is tax-exempt. The volume of all such private activity bonds that each State may issue annually is limited.

78. ***Bonds for private nonprofit educational institutions.***—Interest earned on State and local Government bonds issued to finance the construction of facilities used by private nonprofit educational institutions is not taxed.

79. ***Credit for holders of zone academy bonds.***—Financial institutions that own zone academy bonds receive a non-refundable tax credit (at a rate set by the Treasury Department) rather than interest. The credit is included in gross income. Proceeds from zone academy bonds may only be used to renovate, but not construct, qualifying schools and for certain other school purposes. The total amount of zone academy bonds that may be issued is limited to $1.6 billion—$400 million in each year from 1998 to 2003.

80. ***U.S. savings bonds for education.***—Interest earned on U.S. savings bonds issued after December 31, 1989 is tax-exempt if the bonds are transferred to an educational institution to pay for educational expenses. The tax exemption is phased out for taxpayers with AGI between $87,750 and $117.750 ($58,500 and $73,500 for singles) in 2003.

81. ***Dependent students age 19 or older.***—Taxpayers may claim personal exemptions for dependent children age 19 or over who (1) receive parental support payments of $1,000 or more per year, (2) are full-time students, and (3) do not claim a personal exemption on their own tax returns.

82. ***Charitable contributions to educational institutions.***—Taxpayers may deduct contributions to nonprofit educational institutions. Taxpayers who donate capital assets to educational institutions can deduct the assets' current value without being taxed on any appreciation in value. An individual's total charitable contribution generally may not exceed 50 percent of adjusted gross income; a corporation's total charitable contributions generally may not exceed 10 percent of pre-tax income.

83. ***Employer-provided educational assistance.***—Employer-provided educational assistance is excluded from an employee's gross income even though the employer's costs for this assistance are a deductible business expense. EGTRRA permanently extended this exclusion and extended the exclusion to also include graduate education (beginning in 2002).

84. ***Special deduction for teacher expenses.***—Educators in both public and private elementary and secondary schools, who work at least 900 hours during a school year as a teacher, instructor, counselor, principal or aide, may subtract up to $250 of qualified expenses when figuring their adjusted gross income (AGI).

85. ***Work opportunity tax credit.***—Employers can claim a tax credit for qualified wages paid to individuals who begin work on or before December 31, 2004 and who are certified as members of various targeted groups. The amount of the credit that can be claimed is 25 percent for employment of less than 400 hours and 40 percent for employment of 400 hours or more. The maximum credit per employee is $2,400 and can only be claimed on the first year of wages an individual earns from an employer. Employers must reduce their deduction for wages paid by the amount of the credit claimed.

86. ***Welfare-to-work tax credit.***—An employer is eligible for a tax credit on the first $20,000 of eligible wages paid to qualified long-term family assistance recipients during the first two years of employment. The credit is 35 percent of the first $10,000 of wages in the first year of employment and 50 percent of the first $10,000 of wages in the second year of employment. The maximum credit is $8,500 per employee. The credit applies to wages paid to employees who are hired on or before December 31, 2004.

87. ***Employer-provided child care exclusion.***—Employer-provided child care is excluded from an employee's gross income even though the employer's costs for the child care are a deductible business expense.

88. ***Employer-provided child care credit.***—Employers can deduct expenses for supporting child care or child care resource and referral services. EGTRRA

provides a tax credit to employers for qualified expenses beginning in 2002. The credit is equal to 25 percent of qualified expenses for employee child care and 10 percent of qualified expenses for child care resource and referral services. Employer deductions for such expenses are reduced by the amount of the credit. The maximum total credit is limited to $150,000 per taxable year.

89. ***Assistance for adopted foster children.***—Taxpayers who adopt eligible children from the public foster care system can receive monthly payments for the children's significant and varied needs and a reimbursement of up to $2,000 for nonrecurring adoption expenses. These payments are excluded from gross income.

90. ***Adoption credit and exclusion.***—Taxpayers can receive a nonrefundable tax credit for qualified adoption expenses. The maximum credit is $10,160 per child for 2003. The credit is phased-out ratably for taxpayers with modified AGI between $152,390 and $192,390 in 2003. The credit amounts and the phase-out thresholds are indexed for inflation beginning in 2003. Unused credits may be carried forward and used during the five subsequent years. Taxpayers may also exclude qualified adoption expenses from income, subject to the same maximum amounts and phase-out as the credit. The same expenses cannot qualify for tax benefits under both programs; however, a taxpayer may use the benefits of the exclusion and the tax credit for different expenses. Stepchild adoptions are not eligible for either benefit.

91. ***Employer-provided meals and lodging.***—Employer-provided meals and lodging are excluded from an employee's gross income even though the employer's costs for these items are a deductible business expense.

92. ***Child credit.***—Taxpayers with children under age 17 can qualify for a $1,000 refundable per child credit. The maximum credit is equal to $700 in 2005, $800 in 2009, and $1,000 in 2010, and declines to $500 in 2011 and later years. The credit is phased out for taxpayers at the rate of $50 per $1,000 of modified AGI above $110,000 ($75,000 for singles).

93. ***Child and dependent care expenses.***—Married couples with child and dependent care expenses may claim a tax credit when one spouse works full time and the other works at least part time or goes to school. The credit may also be claimed by single parents and by divorced or separated parents who have custody of children. Expenditures up to a maximum $3,000 for one dependent and $6,000 for two or more dependents are eligible for the credit. The credit is equal to 35 percent of qualified expenditures for taxpayers with incomes of $15,000. The credit is reduced to a minimum of 20 percent by one percentage point for each $2,000 of income in excess of $15,000.

94. ***Disabled access expenditure credit.***—Small businesses (less than $1 million in gross receipts or fewer than 31 full-time employees) can claim a 50-percent credit for expenditures in excess of $250 to remove access barriers for disabled persons. The credit is limited to $5,000.

95. ***Charitable contributions, other than education and health.***—Taxpayers may deduct contributions to charitable, religious, and certain other nonprofit organizations. Taxpayers who donate capital assets to charitable organizations can deduct the assets' current value without being taxed on any appreciation in value. An individual's total charitable contribution generally may not exceed 50 percent of adjusted gross income; a corporation's total charitable contributions generally may not exceed 10 percent of pre-tax income.

96. ***Foster care payments.***—Foster parents provide a home and care for children who are wards of the State, under contract with the State. Compensation received for this service is excluded from the gross incomes of foster parents; the expenses they incur are nondeductible.

97. ***Parsonage allowances.***—The value of a minister's housing allowance and the rental value of parsonages are not included in a minister's taxable income.

Health

98. ***Employer-paid medical insurance and expenses.***—Employer-paid health insurance premiums and other medical expenses (including long-term care) are deducted as a business expense by employers, but they are not included in employee gross income. The self-employed also may deduct part of their family health insurance premiums.

99. ***Self-employed medical insurance premiums.***—Self-employed taxpayers may deduct a percentage of their family health insurance premiums. Taxpayers without self-employment income are not eligible for the special percentage deduction. The deductible percentage is 60 percent in 2001, 70 percent in 2002, and 100 percent in 2003 and thereafter.

100. ***Medical and health savings accounts.***—Some employees may deduct annual contributions to a medical savings account (MSA); employer contributions to MSAs (except those made through cafeteria plans) for qualified employees are also excluded from income. An employee may contribute to an MSA in a given year only if the employer does not contribute to the MSA in that year. MSAs are only available to self-employed individuals or employees covered under an employer-sponsored high deductible health plan of a small employer. The maximum annual MSA contribution is 75 percent of the deductible under the high deductible plan for family coverage (65 percent for individual coverage). Earnings from MSAs are excluded from taxable income. Distributions from an MSA for medical expenses are not taxable. The number of taxpayers who may benefit annually from MSAs is generally limited to 750,000. No new MSAs may be established after December 31, 2003. The Medicare Prescription Drug, Improvemnet, and Modernization Act of 2003 introduced health savings accounts (HSA) which provides a tax-favored savings for health care expenses. The definition of a high-

deductible health plan is less restrictive for HSAs than for MSAs.

101. ***Medical care expenses.***—Personal expenditures for medical care (including the costs of prescription drugs) exceeding 7.5 percent of the taxpayer's adjusted gross income are deductible.

102. ***Hospital construction bonds.***—Interest earned on State and local government debt issued to finance hospital construction is excluded from income subject to tax.

103. ***Charitable contributions to health institutions.***—Individuals and corporations may deduct contributions to nonprofit health institutions. Tax expenditures resulting from the deductibility of contributions to other charitable institutions are listed under the education, training, employment, and social services function.

104. ***Orphan drugs.***—Drug firms can claim a tax credit of 50 percent of the costs for clinical testing required by the Food and Drug Administration for drugs that treat rare physical conditions or rare diseases.

105. ***Blue Cross and Blue Shield.***—Blue Cross and Blue Shield health insurance providers in existence on August 16, 1986 and certain other nonprofit health insurers are provided exceptions from otherwise applicable insurance company income tax accounting rules that substantially reduce (or even eliminate) their tax liabilities.

106. ***Tax credit for health insurance purchased by certain displaced and retired individuals.***—The Trade Act of 2002 provided a refundable tax credit of 65 percent for the purchase of health insurance covergae by individuals eligible for Trade Adjustment Assitance and certain PBGC pension recipients.

Income Security

107. ***Railroad retirement benefits.***—Railroad retirement benefits are not generally subject to the income tax unless the recipient's gross income reaches a certain threshold. The threshold is discussed more fully under the Social Security function.

108. ***Workers' compensation benefits.***—Workers compensation provides payments to disabled workers. These benefits, although income to the recipients, are not subject to the income tax.

109. ***Public assistance benefits.***—Public assistance benefits are excluded from tax. The normal tax method considers cash transfers from the Government as taxable and, thus, treats the exclusion for public assistance benefits as a tax expenditure.

110. ***Special benefits for disabled coal miners.***—Disability payments to former coal miners out of the Black Lung Trust Fund, although income to the recipient, are not subject to the income tax.

111. ***Military disability pensions.***—Most of the military pension income received by current disabled retired veterans is excluded from their income subject to tax.

112. ***Employer-provided pension contributions and earnings.***—Certain employer contributions to pension plans are excluded from an employee's gross income even though the employer can deduct the contributions. In addition, the tax on the investment income earned by the pension plans is deferred until the money is withdrawn.

113. ***401(k) plans.***—Individual taxpayers can make tax-preferred contributions to certain types of employer-provided 401(k) plans (and 401(k)-type plans like 403(b) plans and the Federal government's Thrift Savings Plan). In 2001, an employee could exclude up to $12,000 of wages from AGI under a qualified arrangement with an employer's 401(k) plan. This increases to $13,000 in 2004, $14,000 in 2005 and $15,000 in 2006 (indexed thereafter). The tax on the investment income earned by 401(k)-type plans is deferred until withdrawn.

Employees are allowed to make after-tax contributions to 401(k) and 401(k)-type plans. These contributions are not excluded from AGI, but the investment income of such after-tax contributions is not taxed when earned or withdrawn.

114. ***Individual Retirement Accounts.***—Individual taxpayers can take advantage of several different Individual Retirement Accounts (IRAs): deductible IRAs, non-deductible IRAs, and Roth IRAs. The annual contributions limit applies to the total of a taxpayer's deductible, non-deductible, and Roth IRAs contributions. The IRA contribution limit to $3,000 in 2003, $4,000 in 2005, and $5,000 in 2008 (indexed thereafter) and allows taxpayers over age 50 to make additional "catch-up" contributions of $1,000 (by 2006).

Taxpayers whose AGI is below $70,000 ($50,000 for non-joint filers) in 2003 can claim a deduction for IRA contributions. The IRA deduction is phased out for taxpayers with AGI between $60,000 and $70,000 ($40,000 and $50,000 for non-joint). The phase-out range increases annually until it reaches $80,000 to $100,000 in 2007 ($50,000 to $60,000 in 2005 for non-joint filers). Taxpayers whose AGI is above the phase-out range can also claim a deduction for their IRA contributions depending on whether they (or their spouse) are an active participant in an employer-provided retirement plan. The tax on the investment income earned by 401(k) plans, non-deductible IRAs, and deductible IRAs is deferred until the money is withdrawn.

Taxpayers with incomes below $160,000 ($110,000 for nonjoint filers) can make contributions to Roth IRAs. The maximum contribution to a Roth IRA is phased out for taxpayers with AGI between $150,000 and $160,000 ($95,000 and $110,000 for singles). Investment income of a Roth IRA is not taxed when earned nor when withdrawn. Withdrawals from a Roth IRA are penalty free if: (1) the Roth IRA was opened at least 5 years before the withdrawal, and (2) the taxpayer either (a) is at least 59^{1}2, (b) dies, (c) is disabled, or (d) purchases a first-time house.

Taxpayers can contribute to a non-deductible IRA regardless of their income and whether they are an active participant in an employer-provided retirement plan. The tax on investment income earned by non-deductible IRAs is deferred until the money is withdrawn.

115. ***Low and moderate income savers' credit.***—EGTRRA provides an additional incentive for lower-income taxpayers to save through a nonrefundable credit of up to 50 percent on IRA contributions. This credit is in addition to any deduction or exclusion. The credit is completely phased out by $50,000 for joint filers and $25,000 for single filers. This temporary credit is in effect from 2002 through 2006.

116. ***Keogh plans.***—Self-employed individuals can make deductible contributions to their own retirement (Keogh) plans equal to 25 percent of their income, up to a maximum of $40,000 in 2001. Total plan contributions are limited to 25 percent of a firm's total wages. The tax on the investment income earned by Keogh plans is deferred until withdrawn.

117. ***Employer-provided life insurance benefits.***—Employer-provided life insurance benefits are excluded from an employee's gross income even though the employer's costs for the insurance are a deductible business expense.

118. ***Small business retirement plan credit.***—EGTRRA provides businesses with 100 or fewer employees a credit for 50 percent of the qualified startup costs associated with a new qualified retirement plan. The credit is limited to $500 annually and may only be claimed for expenses incurred during the first three years from the start of the qualified plan. Qualified startup expenses include expenses related to the establishment and administration of the plan, and the retirement-related education of employees. The credit applies to costs incurred beginning in 2002.

119. ***Employer-provided accident and disability benefits.***—Employer-provided accident and disability benefits are excluded from an employee's gross income even though the employer's costs for the benefits are a deductible business expense.

120. ***Employer-provided supplementary unemployment benefits.***—Employers may establish trusts to pay supplemental unemployment benefits to employees separated from employment. Interest payments to such trusts are exempt from taxation.

121. ***Employer Stock Ownership Plan (ESOP) provisions.***—ESOPs are a special type of tax-exempt employee benefit plan. Employer-paid contributions (the value of stock issued to the ESOP) are deductible by the employer as part of employee compensation costs. They are not included in the employees' gross income for tax purposes, however, until they are paid out as benefits. The following special income tax provisions for ESOPs are intended to increase ownership of corporations by their employees: (1) annual employer contributions are subject to less restrictive limitations; (2) ESOPs may borrow to purchase employer stock, guaranteed by their agreement with the employer that the debt will be serviced by his payment (deductible by him) of a portion of wages (excludable by the employees) to service the loan; (3) employees who sell appreciated company stock to the ESOP may defer any taxes due until they withdraw benefits; and (4) dividends paid to ESOP-held stock are deductible by the employer.

122. ***Additional deduction for the blind.***—Taxpayers who are blind may take an additional $1,150 standard deduction if single, or $950 if married in 2003.

123. ***Additional deduction for the elderly.***—Taxpayers who are 65 years or older may take an additional $1,150 standard deduction if single, or $950 if married in 2003.

124. ***Tax credit for the elderly and disabled.***—Individuals who are 65 years of age or older, or who are permanently disabled, can take a tax credit equal to 15 percent of the sum of their earned and retirement income. Income is limited to no more than $5,000 for single individuals or married couples filing a joint return where only one spouse is 65 years of age or older, and up to $7,500 for joint returns where both spouses are 65 years of age or older. These limits are reduced by one-half of the taxpayer's adjusted gross income over $7,500 for single individuals and $10,000 for married couples filing a joint return.

125. ***Casualty losses.***—Neither the purchase of property nor insurance premiums to protect its value are deductible as costs of earning income; therefore, reimbursement for insured loss of such property is not reportable as a part of gross income. Taxpayers, however, may deduct uninsured casualty and theft losses of more than $100 each, but only to the extent that total losses during the year exceed 10 percent of AGI.

126. ***Earned income tax credit (EITC).***—The EITC may be claimed by low income workers. For a family with one qualifying child, the credit is 34 percent of the first $7,490 of earned income in 2003. The credit is 40 percent of the first $10,510 of income for a family with two or more qualifying children. The credit is phased out beginning when the taxpayer's income exceeds $13,730 at the rate of 15.98 percent (21.06 percent if two or more qualifying children are present). It is completely phased out when the taxpayer's modified adjusted gross income reaches $29,666 ($33,692 if two or more qualifying children are present).

The credit may also be claimed by workers who do not have children living with them. Qualifying workers must be at least age 25 and may not be claimed as a dependent on another taxpayer's return. The credit is not available to workers age 65 or older. In 2003, the credit is 7.65 percent of the first $4,990 of earned income. When the taxpayer's income exceeds $6,240, the credit is phased out at the rate of 7.65 percent. It is completely phased out at $11,230 of modified adjusted gross income.

For workers with or without children, the income levels at which the credit begins to phase-out and the maximum amounts of income on which the credit can be taken are adjusted for inflation. For married taxpayers filing a joint return, The base amount for the phase-out increases by $2,000 in 2005 through 2007, and $3,000 in 2008 (indexed thereafter).

Earned income tax credits in excess of tax liabilities owed through the individual income tax system are refundable to individuals. This portion of the credit is shown as an outlay, while the amount that offsets tax liabilities is shown as a tax expenditure.

Social Security

127. ***Social Security benefits for retired workers.***—The non-taxation of Social Security benefits that exceed the beneficiary's contributions out of taxed income is a tax expenditure. These additional retirement benefits are paid for partly by employers' contributions that were not included in employees' taxable compensation. Portions (reaching as much as 85 percent) of recipients' Social Security and Tier 1 Railroad Retirement benefits are included in the income tax base, however, if the recipient's provisional income exceeds certain base amounts. Provisional income is equal to adjusted gross income plus foreign or U.S. possession income and tax-exempt interest, and one half of Social Security and tier 1 railroad retirement benefits. The tax expenditure is limited to the portion of the benefits received by taxpayers who are below the base amounts at which 85 percent of the benefits are taxable.

128. ***Social Security benefits for the disabled.***—Benefit payments from the Social Security Trust Fund for disability are partially excluded from a beneficiary's gross incomes.

129. ***Social Security benefits for dependents and survivors.***—Benefit payments from the Social Security Trust Fund for dependents and survivors are partially excluded from a beneficiary's gross income.

Veterans Benefits and Services

130. ***Veterans death benefits and disability compensation.***—All compensation due to death or disability paid by the Veterans Administration is excluded from taxable income.

131. ***Veterans pension payments.***—Pension payments made by the Veterans Administration are excluded from gross income.

132. ***G.I. Bill benefits.***—G.I. Bill benefits paid by the Veterans Administration are excluded from gross income.

133. ***Tax-exempt mortgage bonds for veterans.***—Interest earned on general obligation bonds issued by State and local governments to finance housing for veterans is excluded from taxable income. The issuance of such bonds is limited, however, to five pre-existing State programs and to amounts based upon previous volume levels for the period January 1, 1979 to June 22, 1984. Furthermore, future issues are limited to veterans who served on active duty before 1977.

General Government

134. ***Public purpose State and local bonds.***—Interest earned on State and local government bonds issued to finance public-purpose construction (e.g., schools, roads, sewers), equipment acquisition, and other public purposes is tax-exempt. Interest on bonds issued by Indian tribal governments for essential governmental purposes is also tax-exempt.

135. ***Deductibility of certain nonbusiness State and local taxes.***—Taxpayers may deduct State and local income taxes and property taxes even though these taxes primarily pay for services that, if purchased directly by taxpayers, would not be deductible.

136. ***Business income earned in U.S. possessions.***—U.S. corporations operating in a U.S. possession (e.g., Puerto Rico) can claim a credit against some or all of their U.S. tax liability on possession business income. The credit expires December 31, 2005.

Interest

137. ***U.S. savings bonds.***—Taxpayers may defer paying tax on interest earned on U.S. savings bonds until the bonds are redeemed.

Appendix:

TREASURY REVIEW OF THE TAX EXPENDITURE PRESENTATION

This appendix provides an initial presentation of the Treasury Department review of the tax expenditure budget, which was first prepared for the 2004 Budget. The review focuses on three issues: (1) using comprehensive income as a baseline tax system, (2) using a consumption tax as a baseline tax system, and (3) defining negative tax expenditures (provisions that cause taxpayers to pay too much tax).

The first section of this appendix compares major tax expenditures in the current budget to those implied by a comprehensive income baseline. This comparison includes a discussion of negative tax expenditures. The second section compares the major tax expenditures in the current budget to those implied by a consumption tax baseline, and also discusses negative tax expenditures. The final section addresses concerns that have been raised over the measurement of some current tax expenditures by describing a new estimate of the tax expenditure caused by accelerated depreciation and alternative estimates of the tax expenditures resulting from the tax exemption of the return earned on owner-occupied housing and preferential treatment of capital gains. The final section also provides an estimate of the negative tax expenditure caused by the double tax on corporate profits.

DIFFERENCES BETWEEN OFFICIAL TAX EXPENDITURES AND THOSE BASED ON COMPREHENSIVE INCOME

As discussed in the main body of the tax expenditure chapter, official tax expenditures are measured relative to normal law or reference law baselines that deviate from a uniform tax on a comprehensive concept of income. Consequently, tax expenditures identified in the budget can differ from those that would be identified if a comprehensive income tax were chosen as the baseline tax system. This appendix addresses this issue by comparing major tax expenditures listed in the current tax expenditure budget with those implied by a comprehensive income baseline. Most large tax expenditures would continue to be tax expenditures were the baseline taken to be comprehensive income, although some would be much smaller. A comprehensive income baseline would also result in a number of additional tax provisions being counted as tax expenditures.

Current budgetary practice excludes from the list of official tax expenditures those provisions that over-tax certain items of income. This exclusion conforms to the view that tax expenditures are substitutes for direct Government spending programs. However, this treatment gives a one-sided picture of how current law deviates from the baseline tax system. Relative to comprehensive income, a number of current tax provisions would be negative tax expenditures. Some of these also might be negative tax expenditures under the reference law or normal law baselines, expanded to admit negative tax expenditures.

Treatment of Major Tax Expenditures from the Current Budget under a Comprehensive Income Tax Baseline

Comprehensive income, also called Haig-Simons income, is the real, inflation adjusted, accretion to one's economic power arising between two points in time, e.g., the beginning and ending of the year. It includes all accretions to wealth, whether or not realized, whether or not related to a market transaction, and whether a return to capital or labor. Inflation adjusted capital gains (and losses) would be included in comprehensive income as they accrue. Business, investment, and casualty losses, including losses caused by depreciation, would be deducted. Implicit returns, such as those accruing to homeowners, also would be included in comprehensive income. A comprehensive income tax baseline would tax all sources of income once. Thus, it would not include a separate tax on corporate income that leads to the double taxation of corporate income.

While comprehensive income can be defined on the sources side of the consumer's balance sheet, it sometimes is instructive to use the identity between the sources of wealth and the uses of wealth to redefine it as the sum of consumption during the period plus the change in net worth between the beginning and the end of the period.

Comprehensive income is widely held to be the idealized base for an income tax even though it is not a perfectly defined concept.[6] It suffers from conceptual ambiguities, some of which are discussed below, as well as practical problems in measurement and tax administration, e.g., how to implement a practicable deduction for economic depreciation or include in income the return earned on consumer durable goods, including housing, automobiles, and major appliances.

Furthermore, comprehensive income does not necessarily represent an ideal tax base; efficiency or equity might be improved by deviating from comprehensive income as a tax base, e.g., by reducing the tax on capital income in order to further spur economic growth or by subsidizing certain types of activities in order to correct for market failures or to improve the after-tax distribution of income. In addition, some elements of comprehensive income would be difficult or impossible to include in a tax system that is administrable.

Classifying items under a comprehensive income baseline is difficult, in part because of the ambiguity of the baseline. It also is difficult because of interactions between tax provisions (or their absence). These interactions mean that it may not always be appropriate to consider each item in isolation. Nonetheless, Appendix Table 1 attempts such a classification for each of the thirty largest tax expenditures from the Budget.

We classify fourteen of the thirty items as tax expenditures under a comprehensive tax base (those in panel A). Most of these give preferential tax treatment to the return on certain types of savings or investment. They are a result of the explicitly hybrid nature of the existing tax system, and arise out of policy decisions that reflect discomfort with the high tax rate on capital income that would otherwise arise under the current structure of the income tax. Even these relatively clear cut items, however, can raise ambiguities particularly in light of the absence of integration of the corporate and individual tax systems. Consider, for example, the tax expenditures related to retirement savings. Considered alone, these items clearly would be tax expenditures under a comprehensive income tax baseline. However, much of the income earned in these accounts is subject to the corporate income tax, and would not be taxed again under a comprehensive income tax. If account is taken simultaneously of the corporate income tax and the individual income tax, then much of what is measured in these tax expenditures might not be considered preferential tax treatment under a comprehensive income tax baseline. But, if the corporate level income tax is separately itemized as a surcharge, or a negative tax expenditure, then the preferential treatments of retirement saving would remain tax expenditures.

[6] See, e.g., David F. Bradford, *Untangling the Income Tax* (Cambridge, MA: Harvard University Press, 1986), pp. 15–31, and Richard Goode, "The Economic Definition of Income" in Joseph Pechman, ed., *Comprehensive Income Taxation* (Washington, D.C.: The Brookings Institution, 1977), pp. 1–29.

The exclusion of worker's compensation benefits also would be a tax expenditure under comprehensive income principles. Under comprehensive income tax principles, if the worker were to buy the insurance himself, he would be able to deduct the premium (since it represents a reduction in net worth) but should include in income the benefit when paid (since it represents an increase in net worth).[7] If the employer pays the premium, the proper treatment would allow the employer a deduction and allow the employee to disregard the premium, but he would take the proceeds, if any, into income. Current law allows the employer to deduct the premium and excludes both the premium and the benefits from the employee's tax base.

Panel B deals with items that probably are tax expenditures, but that raise some issues. The step-up of basis at death lowers the income tax on capital gains for those who inherit assets below what it would be otherwise. From that perspective it would be a tax expenditure under a comprehensive income baseline. Nonetheless, there are ambiguities. Under a comprehensive income baseline, all real inflation adjusted gains would be taxed as accrued, so there would be no deferred unrealized gains on assets held at death.

The lack of full taxation of Social Security benefits also is listed in panel B. Consider first Social Security retirement benefits. To the extent that Social Security is viewed as a pension, a comprehensive income tax would include in income all contributions to Social Security retirement funds (payroll taxes) and tax accretions to value as they arise (inside build-up).[8] Benefits paid out of prior contributions and the inside build-up, however, would not be included in the tax base because the fall in the value of the individual's Social Security account would be offset by an increase in cash. In contrast, to the extent that Social Security is viewed as a transfer program, all contributions should be deductible from the income tax base and all benefits received should be included in the income tax base.

A similar analysis applies to Social Security benefits paid to dependents and survivors. If these benefits represent transfers from the Government, then they should be included in the tax base. If the taxpaying unit consists of the worker plus dependents and survivors, then to the extent that Social Security benefits represent payments from a pension, the annual pension earnings should be taxed in the same way that earnings accruing to retirees are taxed. However, benefits paid to dependents and survivors might be viewed as a gift or transfer from the decedent, in which case the dependents and survivors should pay tax on the full amount of the benefit received. (In this case the decedent or his estate should pay tax on the pension income as well, to the extent that the gift represents consumption rather than a reduction in net worth).

In addition, dependent and survivors benefits might be viewed in part as providing life insurance. In that case, the annual premiums paid each year, or the portion of Social Security taxes attributable to the premiums, should be deducted from income, since they represent a decline in net worth, while benefits should be included in income. Alternatively, taxing premiums and excluding benefits also would represent appropriate income tax policy.

In contrast to any of these treatments, current law excludes one-half of contributions (employer-paid payroll taxes) from the base of the income tax, makes no attempt to tax accretions, and subjects some, but not all, benefits to taxation. The difference between current law's treatment of Social Security benefits and their treatment under a comprehensive income tax would qualify as a tax expenditure, but such a tax expenditure differs in concept from that included in the official budget.

The tax expenditures in the official budget[9] reflect exemptions for lower income beneficiaries from the tax on 85 percent of Social Security benefits.[10] Historically, payroll taxes paid by the employee represented no more than 15 percent of the expected value of the retirement benefits received by a lower-earnings Social Security beneficiary. The 85 percent inclusion rate is therefore intended to tax the remaining amount of the retirement benefit payment arising from the payroll tax contributions made by employers and the implicit return on the employee and employer contributions. Thus, the tax expenditure conceived and measured in the current budget is not intended to capture the deviation from comprehensive income baseline, which would additionally account for the deferral of tax on these components (less an inflation adjustment attributable to the employee's payroll tax contributions). Rather, it is intended to approximate the taxation of private pensions with employee contributions made from after-tax income,[11] on the assumption that Social Security is comparable to such pensions. Hence, the official tax expenditure understates the tax advantage accorded Social Security retirement benefits relative to a comprehensive income baseline.

To the extent that the benefits paid to dependents and survivors should be taxed as private pensions, the same conclusion applies: the official tax expenditure understates the tax advantage.

To the extent that the personal and dependent care exemptions and the standard deduction properly remove from taxable income all expenditures that do not

[7] Suppose a taxpayer buys a one year term unemployment insurance policy at the beginning of the year. At that time he exchanges one asset, cash, for another, the insurance policy, so there is no change in net worth. But, at the end of the year, the policy expires and so is worthless, hence the taxpayer has a reduction in net worth equal to the premium. If the policy pays off during the year (i.e., the taxpayer has a work related injury), then the taxpayer would include the proceeds in income because they represent an increase in his net worth.

[8] As a practical matter, this may be impossible to do. Valuing claims subject to future contingencies is very difficult, as discussed in Bradford, *Untangling the Income Tax,* pp. 23–24.

[9] This includes the tax expenditure for benefits paid to workers, that for benefits paid to survivors and dependents, and that for benefits paid to dependents.

[10] The current budget does not include as a tax expenditure the absence of income taxation on the employer's contributions (payroll taxes) to Social Security retirement at the time these contributions are made.

[11] Private pensions allow the employee to defer tax on all inside build-up. They also allow the employee to defer tax on contributions made by the employer, but not on contributions made directly by the employee. Applying these tax rules to Social Security would require the employee to include in his taxable income benefits paid out of inside build-up and out of the employer's contributions, but would allow the employee to exclude from his taxable income benefits paid out of his own contributions.

yield consumption value, then the child care credit and the earned income tax credit would be tax expenditures. In contrast, a competing perspective views these credits as appropriate modifications that account for differing taxpaying capacity. Even accepting this competing perspective, however, one might question why these programs come in the form of credits rather than deductions.

The next category (panel C) includes items whose treatment is less certain. The proper treatment of some of these items under a comprehensive income tax is ambiguous, while others perhaps serve as proxies for what would be a tax expenditure under a comprehensive income base.[12] Consider, for example, the items relating to charitable contributions. Under existing law, charitable contributions are deductible, and this deduction is considered on its face a tax expenditure in the current budget.[13]

The treatment of charitable donations, however, is ambiguous under a comprehensive income tax. If charitable contributions are a consumption item for the giver, then they are properly included in his taxable income; a deduction for contributions would then be a tax expenditure relative to a comprehensive income tax baseline. In contrast, charitable contributions could represent a transfer of purchasing power from the giver to the receiver. As such, they would represent a reduction in the giver's net worth, not an item of consumption, and so properly would be deductible, implying that current law's treatment is not a tax expenditure. At the same time, the value of the charitable benefits received is income to the recipient. Under current law, such income generally is not taxed, and so represents a tax expenditure whose size might be approximated by the size of the donor's contribution.[14]

Medical expenditures may or may not be an element of income (or consumption), depending on one's point of view. Some argue that medical expenditures don't represent discretionary spending, and so aren't consumption. Instead, they are a reduction of net worth and should be excluded from the tax base. Others argue that there is no way to logically distinguish medical care from other consumption items. Moreover, clearly there is choice in health care decisions, e.g., whether to go to the best doctor, whether to have voluntary surgical procedures, and whether to exercise and eat nutritiously so as to improve and maintain one's health and minimize medical expenditures.

The exemption of full taxation of Social Security benefits paid to the disabled also raises some issues. Social Security benefits for the disabled most closely resemble either Government transfers or insurance. A comprehensive income tax would require the worker to include the benefit fully in his income and would allow him to deduct associated Social Security taxes. If viewed as insurance, he also could include the premium (i.e., tax) and exclude the benefit. The deviation between such treatment and current law's treatment (described above) would be a tax expenditure under a comprehensive income baseline.

In contrast, as described above, the official tax expenditure measures the benefit of exemption for low income beneficiaries from the tax on 85 percent of Social Security benefits. This measurement does not correspond closely to that required under a comprehensive income base. If the payment of the benefit is viewed as a transfer and divorced from the treatment of Social Security taxes, then the current tax expenditure understates the tax expenditure measured relative to a comprehensive income baseline. If the payment of the benefit is viewed as a transfer but the inability to deduct the employee's share of the Social Security tax is simultaneously considered, then it is less likely that the current tax expenditure overstates the tax expenditure relative to a comprehensive income baseline, and in some cases it may generate a negative tax expenditure. Negative tax expenditures arise when the actual tax treatment imposes a higher tax burden than would the baseline tax system, and are discussed in more detail below. If the benefit is viewed as insurance and the tax as a premium, then the current tax expenditure overstates the tax expenditure relative to a comprehensive income baseline. Indeed, in the insurance model, the ability to exclude from tax only $^{1}{}_{2}$ of the premium might suggest that $^{1}{}_{2}$ of the payout should be taxed, so that the current tax rules impose a greater tax burden than that implied by a comprehensive income tax, i.e., a negative tax expenditure.

The deduction of nonbusiness state and local taxes other than on owner-occupied homes also is included here. These taxes include both income taxes and property taxes. The stated justification for this tax expenditure is that "Taxpayers may deduct State and local income taxes and property taxes even though these taxes primarily pay for services that, if purchased directly by taxpayers, would not be deductible."[15] The idea is that these taxes represent consumption expenditures, and so are elements of income.

In contrast to the view in the official budget, the deduction for State and local taxes might not be a tax expenditure if the baseline were comprehensive income. Properly measured comprehensive income would include the value of State and local government benefits received, but would allow a deduction for State and local taxes paid.[16] Thus, in this sense the deductibility of State and local taxes is consistent with comprehensive income tax principles; it should not be a tax expenditure. However, imputing the value of State and local services may be difficult and, as a rough correction, the tax system might disallow the deduction for State and local taxes.[17] So, if the value of services

[12] See, for example, Goode, *The Economic Definition of Income,* pp. 16–17, and Bradford, Untangling the Income Tax, pp. 19–21, and pp.30–31.

[13] The item also includes gifts of appreciated property, at least part of which represents a tax expenditure relative to an ideal income tax, even if one assumes that charitable donations are not consumption.

[14] If recipients tend to be in lower tax brackets, then the tax expenditure is smaller than when measured at the donor's tax rates.

[15] *Fiscal Year 2003 Budget of the United States Government, Analytical Perspectives* (Washington, D.C.: U.S. Government Printing Office, 2002) p. 127.

[16] U.S. Treasury, Blueprints for Basic Tax Reform (Washington, D.C.: U.S. Government Printing Office, 1977) p. 92.

[17] Home mortgage interest and property taxes on owner-occupied housing raise the same ambiguity. Classifying them as probably not tax expenditures arguably is inconsistent. It

from State and local governments is excluded from the tax base, as it generally is under current law, a deduction for taxes might be viewed as a tax expenditure relative to a comprehensive income baseline.[18]

Mortgage interest would be deductible from the base of a comprehensive income tax, since comprehensive income would include implicit rental income on owner-occupied housing. Similarly, property taxes on owner-occupied housing would be deductible, since they represent a reduction in net worth. One could argue, however, that because current law does not impute rental income nor does it impute the value of Government services, the home mortgage interest deduction and the deduction for property taxes move away from rather than towards the outcome observed under a comprehensive income tax base, and so might be considered tax expenditures. Alternatively, they might be viewed as proxies for the correct tax expenditures. They are, however, extremely crude proxies for the implicit rental income earned on owner-occupied housing. The interest deduction proxy, for example, understates the extent of the tax expenditure associated with ignoring implicit rental income to the extent a house is unencumbered by a mortgage that approximates the house's market value, and does not include the effects on net income of such costs as depreciation, maintenance, and repairs.

The final category (panel D) includes items that would not be tax expenditures under a comprehensive income tax base. Most versions of a comprehensive income tax would assign tax liability to individuals. There would be no separate corporation income tax. Hence, the issue of graduated corporate tax rates would not arise.[19] A tax based on comprehensive income would allow all losses to be deducted. Hence, the exception from the passive loss rules would not be a tax expenditure.[20]

Major Tax Expenditures under a Comprehensive Income Tax That Are Excluded from the Current Budget

While most of the major tax expenditures in the current budget also would be tax expenditures under a comprehensive income base, there also are tax expenditures relative to a comprehensive income base that are not found on the existing tax expenditure list. These additional tax expenditures include the imputed return from consumer durables and owner-occupied housing, the difference between capital gains (and losses) as they accrue and capital gains as they are realized, private gifts and inheritances received, in-kind benefits from such Government programs as food-stamps, Medicaid, and public housing, the value of payouts from insurance policies,[21] and benefits received from private charities. Under some ideas of comprehensive income, the value of leisure and of household production of goods and services also would be included as tax expenditures. The personal exemption and standard deduction also might be considered tax expenditures, although they can be viewed differently, e.g., as elements of the basic tax rate schedule. The foreign tax credit also might be a tax expenditure, since a deduction for foreign taxes, rather than a credit, would seem to measure the income of U.S. residents properly.

Negative Tax Expenditures

Under current budgetary practice, negative tax expenditures, tax provisions that raise rather than lower taxes, are excluded from the official tax expenditure list. This exclusion conforms with the view that tax expenditures are intended to be similar to Government spending programs.

If attention is expanded from a focus on spending-like programs to include any deviation from the baseline tax system, negative tax expenditures would be of interest. Relative to a comprehensive income baseline, there are a number of important negative tax expenditures, some of which also might be viewed as negative tax expenditures under an expanded interpretation of the normal or reference law baseline. Among the more important negative tax expenditures is the corporation income tax, or more generally the double tax on corporate profits, which would be eliminated under a comprehensive income tax. The Jobs and Growth Tax Relief and Reconciliation Act of 2003 (JGTRRA) reduced the tax rate on dividends and capital gains to 15 percent, thus reducing the double tax compared to prior law. Nonetheless, as discussed later in the Appendix, current law still imposes a substantial double tax on corporate profits. The passive loss rules, restrictions on the deductibility of capital losses, and NOL carry-forward requirements each would generate a negative tax expenditure, since a comprehensive income tax would allow full deductibility of losses. If human capital were considered an asset, then its cost (e.g., certain education and training expenses, including perhaps the cost of college and professional school) should be amortizable, but it is not under current law.[22] Some restricted deductions under the individual AMT might be negative tax expenditures as might the phase-out of personal exemptions and of itemized deductions. The inability to deduct consumer interest also might

reflects the judgment that no comprehensive tax is likely to tax the value of State and local services, while it appears somewhat easier to impute and tax the rental income from owner-occupied housing.

[18] Under the normal tax method employed by the Joint Committee on Taxation, the value of some public assistance benefits provided by State Governments is included as a tax expenditure, thereby raising a potential double counting issue.

[19] As discussed below, the double tax on corporate profits would be a major negative tax expenditure.

[20] In contrast, the passive loss rules themselves, which restrict the deduction of losses, would be a negative tax expenditure when compared to a comprehensive tax base.

[21] To the extent that premiums are deductible.

[22] Current law offers favorable treatment to some education costs, thereby creating (positive) tax expenditures. Current law allows expensing of that part of the cost of education and career training that is related to foregone earnings and this would be a tax expenditure under a comprehensive income baseline. In addition, some education has consumption value, and under a comprehensive income definition would be taxable to that extent, but is not taxable under current law.

be a negative tax expenditure, as an interest deduction may be required to properly measure income, as seen by the equivalence between borrowing and reduced lending.[23] As discussed above, the current treatment of Social Security payments to the disabled also might represent a negative tax expenditure, if viewed as payments on an insurance policy.

Current tax law also fails to index for inflation interest receipts, capital gains, depreciation, and inventories. This failure leads to negative tax expenditures because comprehensive income would be indexed for inflation. Current law, however, also fails to index for inflation the deduction for interest payments; this represents a (positive) tax expenditure.

The issue of indexing also highlights that even if one wished to focus only on tax policies that are similar to spending programs, accounting for some negative tax expenditures may be required. For example, the net subsidy created by accelerated depreciation is properly measured by the difference between depreciation allowances specified under existing tax law and economic depreciation, which is indexed for inflation.[24]

DIFFERENCES BETWEEN OFFICIAL TAX EXPENDITURES AND TAX EXPENDITURES RELATIVE TO A CONSUMPTION BASE

This section compares tax expenditures listed in the official tax expenditure budget with those implied by a comprehensive consumption tax baseline. It first discusses some of the difficulties encountered in trying to compare current tax provisions to those that would be observed under a comprehensive consumption tax. Next, it discusses which of the thirty largest official tax expenditures would be tax expenditures under the consumption tax baseline, concluding that about one-half of the top thirty official tax expenditures would remain tax expenditures under a consumption tax baseline. Most of those that fall off the list are tax incentives for saving and investment.

The section next discusses some major differences between current law and a comprehensive consumption tax baseline that are excluded from the current list of tax expenditures. These differences include the consumption value of owner-occupied housing and other consumer durables, benefits from in-kind Government transfers, and gifts. It concludes with a discussion of negative tax expenditures relative to a consumption tax baseline

Ambiguities in Determining Tax Expenditures Relative to a Consumption Baseline

A broad-based consumption tax is a combination of an income tax plus a deduction for net saving. This follows from the definition of comprehensive income as consumption plus the change in net worth. It therefore seems straightforward to say that current law's deviations from a consumption base are the sum of (a) tax expenditures on an income base associated with exemptions and deductions for certain types of income, plus (b) overpayments of tax, or negative tax expenditures, to the extent net saving is not deductible from the tax base. In reality, however, the situation is more complicated. A number of issues arise, some of which also are problems in defining a comprehensive income tax, but seem more severe, or at least only more obvious, for the consumption tax baseline.

It is not always clear how to treat certain items under a consumption tax. One problem is determining whether a particular expenditure is an item of consumption. Spending on medical care and charitable donations are two examples. Another problem relates to foreign source income. It is sometimes argued that a credit for foreign income taxes is inappropriate against the base of a consumption tax. Does that mean that the current foreign tax credit is a tax expenditure for a consumption tax base? The classification below suggests that medical spending and charitable contributions might be included in the definition of consumption, but also considers an alternative view. It makes no judgment about the treatment of foreign taxes, but provides a brief discussion of the issues.

There may be more than one way to treat various items under a consumption tax. For example, a consumption tax might ignore borrowing and lending by excluding from the borrower's tax base the proceeds from loans, denying the borrower a deduction for payments of interest and principal, and excluding interest and principal payments received from the lender's tax base. On the other hand, a consumption tax might include borrowing and lending in the tax base by requiring the borrower to add the proceeds from loans in his tax base, allowing the lender to deduct loans from his tax base, allowing the borrower to deduct payments of principal and interest, and requiring the lender to include receipt of principal and interest payments. In present value terms, the two approaches are equivalent for both the borrower and the lender; in particular both allow the tax base to measure consumption and both impose a zero effective tax rate on interest income. But which approach is taken obviously has different implications (at least on an annual flow basis) for the treatment of many important items of income and expense, such as the home mortgage interest deduction. The classification below suggests that the deduction for home mortgage interest could well be a tax expenditure, but takes note of alternative views.

Some exclusions of income are equivalent in many respects to consumption tax treatment that immediately deducts the cost of an investment while taxing the future cash-flow. For example, exempting invest-

[23] See Bradford, *Untangling the Income Tax,* p. 41.

[24] Accelerated depreciation can be described as the equivalent of an interest free loan from the Government to the taxpayer. Under federal budget accounting principles, such a loan would be treated as an outlay equal to the present value of the foregone interest.

ment income is equivalent to consumption tax treatment as far as the normal rate of return on new investment is concerned. This is because expensing generates a tax reduction that offsets in present value terms the tax paid on the investment's future normal returns. Expensing gives the income from a marginal investment a zero effective tax rate. However, a yield exemption approach differs from a consumption tax as far as the distribution of income and Government revenue is concerned. Pure profits in excess of the normal rate of return would be taxed under a consumption tax, because they are an element of cash-flow, but would not be taxed under a yield exemption tax system. Should exemption of certain kinds of investment income, and certain investment tax credits, be regarded as the equivalent of consumption tax treatment? The classification that follows takes a fairly broad view of this equivalence and considers many tax provisions that reduce or eliminate the tax on capital income to be roughly consistent with a broad-based consumption tax.

Looking at provisions one at a time can be misleading. The hybrid character of the existing tax system leads to many provisions that might make good sense in the context of a consumption tax, but that generate inefficiencies because of the problem of the "uneven playing field" when evaluated within the context of the existing tax rules. It is not clear how these should be classified. For example, many saving incentives are targeted to specific tax favored sources of capital income, and so potentially distort economic choices in ways that would not occur under a broad-based consumption tax. As another example, under a consumption VAT based on the destination principle, there would be a rebate of the VAT on exports and a tax on imports. Does this mean that the extraterritorial income exclusion (the successor of the Foreign Sales Corporation provision) is not a tax expenditure? Resolution comes down to judgments about how broad is broad enough to be considered general, or whether it even matters at all that a provision is targeted in some way. The classification that follows views many savings incentives, even if targeted, as roughly consistent with a broad based consumption tax.

Capital gains would not be a part of a comprehensive consumption tax base. Proceeds from asset sales and sometimes borrowing would be part of the cash-flow tax base, but, for transactions between domestic investors at a flat tax rate, would cancel out in the economy as a whole. How should existing tax expenditures related to capital gains be classified? The classification below generally views available capital gains tax breaks as consistent with a broad-based consumption tax because they lower the tax rate on capital income toward the zero rate that is consistent with a consumption-based tax.

Such considerations suggest that trying to compute the current tax's deviations from "the" base of a consumption tax is impossible because deviations cannot be uniquely determined, making it very difficult to do a consistent accounting of the differences between the current tax base and a consumption tax base. Nonetheless, Appendix Table 2 attempts a classification based on the criteria outlined above.

Treatment of Major Tax Expenditures under a Comprehensive Consumption Baseline

As noted above, the major difference between a comprehensive consumption tax and a comprehensive income tax is in the treatment of saving, or in the taxation of capital income. Consequently, many current tax expenditures related to preferential taxation of capital income would not be tax expenditures under a consumption tax. However, preferential treatment of items of income that is unrelated to moderately broad-based saving or investment incentives would remain tax expenditures under a consumption baseline. In addition, several official tax expenditures relating to items of income and expense are difficult to properly classify, while others may serve as proxies for properly measured tax expenditures.

Appendix Table 2 shows the thirty largest official tax expenditures from the Budget classified according to whether they would be considered a tax expenditure under a consumption tax. One of the thirty items clearly would be a tax expenditure (shown in panel A) under a consumption tax, while an additional four (those in panel B) probably would be tax expenditures.

Exclusion of workers' compensation benefits allows an exclusion from income that is unrelated to investment, and so should be included in the base of a comprehensive consumption tax.

The official tax expenditures for Social Security benefits reflects exceptions for low income taxpayers from the general rule that 85 percent of Social Security benefits are included in the recipient's tax base. The 85 percent inclusion is intended as a simplified mechanism for taxing Social Security benefits as if the Social Security program were a private pension with employee contributions made from after-tax income. Under these tax rules, income earned on contributions made by both employers and employees benefits from tax deferral, but employer contributions also benefit because the employee may exclude them from his taxable income, while the employee's own contributions are included in his taxable income. These tax rules give the equivalent of consumption tax treatment, a zero effective tax rate on the return, to the extent that the original pension contributions are made by the employer, but give less generous treatment to the extent that the original contributions are made by the employee. Income earned on employee contributions is taxed at a low, but positive, effective tax rate. Based on historical calculations, the 85 percent inclusion reflects roughly the outcome of applying these tax rules to a lower-income earner when one-half of the contributions are from the employer and one-half from the employee.

The current tax expenditure measures a tax benefit relative to a baseline that is somewhere between a comprehensive income tax and a consumption tax. The properly measured tax expenditure relative to a consumption tax baseline would include only those Social Security benefits that are accorded treatment more favorable than that implied by a consumption tax, which would correspond to including 50 percent of Social Security benefits in the recipient's tax base.

A similar analysis would apply to exclusion of Social Security benefits of dependents and retirees.

The child credit and the earned income tax credit can be viewed as social welfare programs unrelated to measuring and taxing consumption. As such, they would be tax expenditures relative to a consumption baseline.

The treatment of the items in panels C is less uncertain. Several of these items relate to the costs of medical care or to charitable contributions. As discussed in the previous section of the appendix, there is disagreement within the tax policy community over the extent to which medical care and charitable giving represent consumption items. While widely held to be consumption, a competing view is that they represent reductions in net worth that should be excluded from the tax base because they do not yield direct satisfaction to taxpayer who makes the expenditure.

There also is the issue of how to tax medical insurance premiums. Under current law, employees do not have to include insurance premiums paid for by employers in their income. The self-employed also may exclude (via a deduction) medical insurance premiums from their taxable income. From some perspectives, these premiums should be in the tax base because they appear to represent consumption. Yet an alternative perspective would support excluding the premium from tax as long as the consumption tax base included the value of any medical services paid for by the insurance policy, because the premium equals the expected value of insurance benefits received. But even from this alternative perspective, the official tax expenditure might continue to be a tax expenditure under a consumption tax baseline because current law excludes the value of medical services paid with insurance benefits from the employee's taxable income.

If medical spending is not consumption, one approach to measuring the consumption base would ignore insurance, but allow the consumer to deduct the value of all medical services obtained. An alternative approach would allow a deduction for the premium but include the value of any insurance benefits received, while continuing to allow a deduction for a value of all medical services obtained. In either case, the official tax expenditure for the exclusion of employer provided medical insurance and expenses would not be a tax expenditure relative to a consumption tax baseline.

Consider next the deductibility of home mortgage interest. A consumption tax seeks to tax the consumption value of housing services consumed no matter how the house is financed. From this perspective, home mortgage interest should not be deductible. However, what governs the proper treatment of interest under a consumption tax is whether financial flows are in or out of the consumption tax base. A result equivalent to disallowing the interest deduction would require that the loan be taken into income and would permit the associated interest and principal payments to be deducted. If the loans are taken into income (as they would be under some types of consumption taxes), then the associated interest and principal payments should be deductible, otherwise not. Without specifying how financial flows are treated, it is unclear how to treat the home mortgage interest deduction. Nonetheless, given that loans are not taken into income under current law, and this treatment's equivalency to disallowing the interest deduction, classifying the deduction of home mortgage interest as a tax expenditure might be reasonable.

Ambiguities arise about the proper treatment of State and local taxes under a consumption tax, as they do under an income tax. These taxes are not of themselves consumption items, but might serve as proxies for the value of Government services consumed.

The extraterritorial income exclusion replaces the previous Foreign Sales Corporation program. It provides an exclusion from income for certain exports. To the extent that the program is viewed as a component of a destination based VAT it might not be a tax expenditure. In addition, to the extent that the exclusion is an investment subsidy, it might be consistent with consumption tax principles (i.e., a low tax rate on capital income).

The taxation of Social Security benefits for the disabled also is difficult to classify. As discussed in this appendix above, these benefits generally ought to be taxed because they represent purchasing power. However, the associated Social Security taxes ought to be fully deductible, but they are not. Hence the proper treatment is unclear. Moreover, if the insurance model is applied, the taxation of Social Security benefits might be a negative tax expenditure.

The credit for low income housing acts to lower the tax burden on qualified investment, and so from one perspective would not be a tax expenditure under a consumption tax baseline. However, in some cases the credit is too generous; it can give a negative tax on income from qualified investment rather than the zero tax called for under consumption tax principles. In addition, the credit is very narrowly targeted. Consequently, it could be considered a tax expenditure relative to a consumption tax baseline.

The final panel (D) shows items that are not likely to be tax expenditures under a consumption base. Most of these relate to tax provisions that eliminate or reduce the tax on various types of capital income because a zero tax on capital income is consistent with consumption tax principles. But in those cases where a tax remains, a negative tax expenditure under the consumption tax is created.

The graduated corporate income tax rates would not be a tax expenditure under a comprehensive consumption baseline. A consumption tax would have no tax on corporate income or profits, hence the issue of whether the rate structure on corporate income provides a special benefit to corporations with low income would not arise.

The exception from the passive loss rules probably would not be a tax expenditure because proper measurement of income, and hence of consumption, requires full deduction of losses.

Major Tax Expenditures under a Consumption Tax That Are Excluded from the Current Budget

Several differences between current law and a consumption tax are left off the official tax expenditure list. Additional tax expenditures include the imputed consumption value from consumer durables and owner-occupied housing, private gifts and inheritances received, possibly benefits paid by insurance policies, in-kind benefits from such Government programs as food-stamps, Medicaid, and public housing, and benefits received from charities. Under some ideas of a comprehensive consumption tax, the value of leisure and of household production of goods and services would be included as a tax expenditure.

A consumption tax implemented as a tax on cash flows would tax all proceeds from sales of capital assets when consumed, rather than just capital gains; because of expensing, taxpayers effectively would have a zero basis. The proceeds from borrowing would be in the base of a consumption tax that also allowed a deduction for repayment of principal and interest, but are excluded from the current tax base. The deduction of business interest expense might be a tax expenditure, since under some forms of consumption taxation interest is neither deducted from the borrower's tax base nor included in the lender's tax base. The personal exemption and standard deduction also might be considered tax expenditures, although they can be viewed differently, e.g., as elements of the basic tax rate schedule.

Negative Tax Expenditures

Importantly, current law also deviates from a consumption tax norm in ways that increase, rather than decrease, tax liability. These could be called negative tax expenditures. The official budget excludes negative tax expenditures on the theory that tax expenditures are intended to substitute for Government spending programs. Yet excluding negative tax expenditures would give a very one-sided look at the differences between the existing tax system and a consumption tax.

A large item on this list would be the inclusion of capital income in the current individual income tax base, including the income earned on inside-build up in Social Security accounts. The revenue from the corporation income tax, or more generally a measure of the double tax on corporate profits, also would be a negative tax expenditure. Depreciation allowances, even if accelerated, would be a negative tax expenditure since consumption tax treatment generally would require expensing. Depending on the treatment of loans, the borrower's inability to deduct payments of principal and the lender's inability to deduct loans might be a negative tax expenditure. The passive loss rules, restrictions on the deductibility of capital losses, and NOL carryforward provisions also would generate negative tax expenditures, because the change in net worth requires a deduction for losses. If human capital were considered an asset, then its cost (e.g., certain education and training expenses, including perhaps costs of college and professional school) should be expensed, but it is not under current law. Certain restrictions under the individual AMT as well as the phase-out of personal exemptions and of itemized deductions also might be considered negative tax expenditures. Under some views, the current tax treatment of Social Security benefits paid to the disabled would be a negative tax expenditure.

REVISED ESTIMATES OF SELECTED TAX EXPENDITURES

Accelerated Depreciation

Under the reference tax law baseline no tax expenditures arise from accelerated depreciation. In the past, official tax expenditure estimates of accelerated depreciation under the normal tax law baseline compared tax allowances based on the historic cost of an asset with allowances calculated using the straight-line method over relatively long recovery periods. Normal law allowances also were determined by the historical cost of the asset and so did not adjust for inflation, although such an adjustment is required when measuring economic depreciation, the age related fall in the real value of the asset.

Beginning with the 2004 Budget, the tax expenditures for accelerated depreciation under the normal law concept have been recalculated using as a baseline depreciation rates and replacement cost indexes from the National Income and Product Accounts.[25] The revised estimates are intended to approximate the degree of acceleration provided by current law over a baseline determined by real, inflation adjusted, and economic depreciation. Current law depreciation allowances for machinery and equipment include the benefits of a temporary expensing provision.[26] The estimates are shown in tables in the body of the main text, e.g., Table 18.1.

[25] See Barbara Fraumeni, "The Measurement of Depreciation in the U.S. National Income and Product Accounts," in Survey of Current Business 77 No. 7 (Washington, D.C.: Department of Commerce, Bureau of Economic Analysis, July, 1997), pp. 7–42, and the *National Income and Product Accounts of the United States,* Table 7.6, "Chain-type Quantity and Price Indexes for Private Fixed Investment by Type," U.S. Department of Commerce, Bureau of Economic Analysis.

[26] The temporary provision allows 30 percent of the cost of a qualifying investment to be deducted immediately rather than capitalized and depreciated over time. It is generally effective for qualifying investments made after September 10, 2001 and before September 11, 2004. The Jobs and Growth Tax Relief Reconciliation Act of 2003 raised the deduction to 50 percent depreciation (up from 30 percent) of the cost new equipment purchased after May 5, 2003 and placed into service before January 1, 2005. Qualifying investments generally are limited to tangible property with depreciation recovery periods of 20 years or less, certain software, and leasehold improvements, but this set of assets corresponds closely to machinery and equipment.

The revised tax expenditure estimates differ substantially from estimates calculated under the old methodology. In general, the new tax expenditure estimates are smaller than the old estimates.[27] In part this is because the new baseline uses depreciation allowances that are faster than those in the old baseline. In addition, the new baseline calculates depreciation on a replacement cost basis rather on the historic cost basis previously used; this translates into larger depreciation allowances to the extent that asset prices rise over time. In many years the new tax expenditures are negative, indicating that current law's tax depreciation allowances are smaller than those implied by economic depreciation. Because these estimates are on a cash flow, rather than a present value, basis, the negative value does not necessarily indicate that tax depreciation is decelerated relative to economic depreciation over the life of an investment. Even when tax depreciation is accelerated over the life of an investment, negative annual cash flow estimates could obtain in the later years of an investment's economic life. This type of vintage effect contributes importantly to the negative tax expenditures calculated for equipment in 2005–2009 because the temporary expensing provision expires at the end of 2004. Calculations that compare the present value of tax depreciation (without the temporary expensing) with the present value of inflation indexed economic depreciation over each investment's economic life show that for many types of assets tax depreciation is accelerated, but only slightly, assuming a moderate rate of inflation.[28]

Owner-Occupied Housing

A homeowner receives a flow of housing services equal in gross value to the rent that could have been earned had the owner chosen to rent the house to others. Comprehensive income would include in its base the implicit net rental income earned on investment in owner-occupied housing. Current law, however, excludes from its tax base such net rental income. This exclusion is a tax expenditure relative to a comprehensive income base.

In contrast to a comprehensive income baseline, the official list of tax expenditures does not include the exclusion of implicit rental income on owner-occupied housing. Instead, it includes as tax expenditures deductions for home mortgage interest and for property taxes. These are poor proxies for the exclusion of implicit net rental income. To the extent that a homeowner owns his house outright, unencumbered by a mortgage, he would have no home mortgage interest deduction, yet he still would enjoy the benefits of receiving tax free the implicit rental income earned on his house. When measuring the net income from an investment in owner-occupied housing, mortgage interest and property taxes generally would be deductible. The official tax expenditures do not allow for depreciation and other costs incurred by the homeowner that must be deducted in determining his net rental income.

Appendix Table 3 shows an estimate of the tax expenditure caused by the exclusion of implicit net rental income from investment in owner-occupied housing. This estimate starts with the NIPA calculated value of gross rent on owner-occupied housing, and subtracts interest, taxes, economic depreciation, and other costs in arriving at an estimate of net-rental income from owner-occupied housing.[29]

The tax expenditure estimate is substantial, growing from $24 billion in 2005 to $35 billion in 2009. Nonetheless, it is only about one-third as large as the official tax expenditure for the deduction of home mortgage interest. In part this discrepancy reflects depreciation and other expenses that must be subtracted from gross rents in arriving at net rental income. In part, it also might reflect homeowners' ability to borrow against their homes to fund other spending, leading to a relatively high debt/equity ratio for housing.

Accrued Capital Gains

Under a comprehensive income baseline, all real gains would be taxed as accrued. These gains would be taxed as ordinary income rather than at preferential rates. There would be no deferred unrealized gains on assets held at death, nor gains carried over on gifts, or other preferential treatments. Indeed, all of the provisions related to capitals gains listed in the tax expenditure budget would be dropped. Instead, in their place the difference between the ordinary tax on real gains accrued and the actual tax paid would be calculated. For 1999, for instance, the tax on real accrued gains on corporate equity is estimated at $594 billion. This compares to an estimated tax on realized gains of $62 billion, for forgone revenues of $562 billion. However, this tax expenditure may easily turn into a penalty given the limits on capital losses. For 2000, for instance, real accrued losses in corporate equity amounted to $1.4 trillion. Yet, taxpayers paid an estimated $70 billion in capital gains taxes. This roughly translates into an overpayment of taxes to the tune of $464 billion.

Double Tax on Corporate Profits

A comprehensive income tax would tax all sources of income once. Taxes would not vary by type or source of income.

In contrast to this benchmark, current law taxes income that shareholders earn on investment in corporate stocks at least twice, and at combined rates that generally are higher than those imposed on other sources of income. Corporate profits are taxed once at the company level under the corporation income tax. They are taxed again at the shareholder level when received as a dividend or recognized as a capital gain. Corporate profits can be taxed more then twice when they pass through multiple corporations before being distributed to noncorporate shareholders. Corporate level taxes cas-

[27] Estimates under the old methodology are no longer shown in the tables.

[28] U.S. Department of the Treasury, *Report to the Congress on Depreciation Recovery Periods and Methods* (Washington, D.C.: U.S. Government Printing Office, July, 2000), p. 32.

[29] *National Income and Production Accounts,* Table 2.4.

cade because corporations are taxed on capital gains they realize on the sale of stock shares and on some dividend income received. Compared to a comprehensive income tax current law's double (or more) tax on corporate profits is an example of a negative tax expenditure because it subjects income to a larger tax burden than implied by a comprehensive income baseline.

Appendix Table 3 provides an estimate of the negative tax expenditure caused by the multiple levels of tax on corporate profits. This negative tax expenditure is measured as the shareholder level tax on dividends paid and capital gains realized out of earnings that have been fully taxed at the corporate level. It also includes the corporate tax paid on inter-corporate dividends and on corporate capital gains attributable to the sale of stock shares. The estimate includes the reduction in the dividends and capital gains tax rates enacted in JGTRRA.

The negative tax expenditure is large in magnitude; it exceeds $33 billion in the years 2005 through in 2009. It is comparable in size (but opposite in sign) to all but the largest official tax expenditures. JGTRRA reduced but did not eliminate the double tax on corporate profits.

Appendix Table 1. COMPARISON OF CURRENT TAX EXPENDITURES WITH THOSE IMPLIED BY A COMPREHENSIVE INCOME TAX[1]

(In millions of dollars)

Description	2005 Revenue Effect
A. Tax Expenditure Under a Comprehensive Income Tax	
Net exclusion of pension contributions and earnings: Employer plans	61,740
Net exclusion of pension contributions and earnings: 401(k) plans	58,910
Capital gains (except agriculture, timber, iron ore, and coal)	30,190
Exclusion of interest on public purpose State and local bonds	26,370
Exclusion of interest on life insurance savings	22,130
Capital gains exclusion on home sales	21,490
Net exclusion of pension contributions and earnings: Individual Retirement Accounts	20,090
Net exclusion of pension contributions and earnings: Keogh plans	9,260
Deferral of income from controlled foreign corporations (normal tax method)	8,400
Credit for low-income housing investments	6,860
Exclusion of workers' compensation benefits	6,850
Extraterritorial income exclusion	5,890
Expensing of certain small investments (normal tax method)	4,850
Expensing of research and experimentation expenditures (normal tax method)	4,500
B. Possibly a Tax Expenditure Under a Comprehensive Income Tax, But With Some Qualifications	
Child credit	29,860
Exclusion of Social Security benefits for retired workers	19,040
Step-up basis of capital gains at death	18,240
Earned income tax credit	5,006
Exclusion of Social security benefits of dependents and survivors	4,310
C. Uncertain	
Exclusion of employer contributions for medical insurance premiums and medical care	112,990
Deductibility of mortgage interest on owner-occupied homes	69,740
Deductibility of nonbusiness State and local taxes other than on owner-occupied homes	46,180
Deductibility of charitable contributions, other than education and health	29,670
Deductibility of State and local property tax on owner-occupied homes	19,410
Deductibility of medical expenses	7,900
Deductibility of self-employed medical insurance premiums	3,780
Social Security benefits for disabled	3,720
Deductibility of charitable contributions (education)	3,660
D. Probably Not a Tax Expenditure Under a Comprehensive Income Tax	
Exception from passive loss rules for $25,000 of rental loss	4,390
Graduated corporation income tax rate (normal tax method)	3,910

[1] The measurement of certain tax expenditures under a comprehensive income tax baseline may differ from the official budget estimate even when the provision would be a tax expenditure under both baselines.

Source: Table 18–2, Tax Expenditure Budget.

Appendix Table 2. COMPARISON OF CURRENT TAX EXPENDITURES WITH THOSE IMPLIED BY A COMPREHENSIVE CONSUMPTION TAX [1]

(In millions of dollars)

Description	2005 Revenue Effect
A. Tax Expenditure Under a Consumption Base	
Exclusion of workers' compensation benefits	6,850
B. Probably a Tax Expenditure Under a Consumption Base,	
Child credit	29,860
Exclusion of Social Security benefits for retired workers	19,040
Earned income tax credit	5,006
Exclusion of Social security benefits of dependents and survivors	4,310
C. Uncertain	
Exclusion of employer contributions for medical insurance premiums and medical care	112,990
Deductibility of mortgage interest on owner-occupied homes	69,740
Deductibility of nonbusiness state and local taxes other than on owner-occupied homes	46,180
Deductibility of charitable contributions, other than education and health	29,670
Deductibility of State and local property tax on owner-occupied homes	19,410
Deductibility of medical expenses	7,900
Credit for low-income housing investments	6,860
Extraterritorial income exclusion	5,890
Deductibility of self-employed medical insurance premiums	3,780
Deductibility of charitable contributions (education)	3,660
Social Security benefits for disabled	3,720
D. Not a Tax Expenditure under a Consumption Base	
Net exclusion of pension contributions and earnings: Employer plans	61,740
Net exclusion of pension contributions and earnings: 401(k) plans	58,910
Capital gains (except agriculture, timber, iron ore, and coal) (normal tax method)	30,190
Exclusion of interest on public purpose State and local bonds	26,370
Exclusion of interest on life insurance savings	22,130
Capital gains exclusion on home sales	21,490
Net exclusion of pension contributions and earnings: Individual Retirement Accounts	20,090
Step-up basis of capital gains at death	18,240
Net exclusion of pension contributions and earnings: Keogh plans	9,260
Deferral of income from controlled foreign corporations (normal tax method)	8,400
Expensing of certain small investments (normal tax method)	4,850
Expensing of research and experimentation expenditures (normal tax method)	4,500
Exception from passive loss rules for $25,000 of rental loss	4,390
Graduated corporation income tax rate (normal tax method)	3,910

[1] The measurement of certain tax expenditures under a consumption tax baseline may differ from the official budget estimate even when the provision would be a tax expenditure under both baselines.

Source: Table 6–2, Tax Expenditure Budget.

Appendix Table 3. REVISED TAX EXPENDITURE ESTIMATES [1]

(In millions of dollars)

Provision	Revenue Loss						
	2003	2004	2005	2006	2007	2008	2009
Imputed Rent On Owner-Occupied Housing	18,340	20,540	24,100	25,160	28,250	31,400	34,710
Double Tax on corporate profit [2]	–24,020	–26,740	–34,940	–33,340	–33,260	–33,660	–34,280

[1] Calculations described in the appendix text.

[2] This is a negative tax expenditure, a tax provision that overtaxes income relative to the treatment specified by the baseline tax system.

DIMENSIONS OF THE BUDGET

19. COMPARISON OF ACTUAL TO ESTIMATED TOTALS

In successive budgets, the Administration publishes several estimates of the surplus or deficit for a particular fiscal year. Initially, the year appears as an outyear projection at the end of the budget horizon. In each subsequent budget, the year advances in the estimating horizon until it becomes the "budget year." One year later, the year becomes the "current year" then in progress, and the following year, it becomes the just-completed "actual year."

The budget is legally required to compare budget year estimates of receipts and outlays with the subsequent actual receipts and outlays for that year.[1] Part I of this chapter meets that requirement by comparing the actual results for 2003 with the current services estimates shown in the 2003 Budget published in February 2002.

Part II of the chapter presents a broader comparison of estimates and actual outcomes. This part first discusses the historical record of budget year estimates versus actual results over the last two decades. Second, it broadens the focus to estimates made for each year of the budget horizon, extending four years beyond the budget year. This broader focus shows that the growth in differences between estimates and the eventual actual results grows as the estimates extend further into the future.

PART I: COMPARISON OF ACTUAL TO ESTIMATED TOTALS FOR 2003

This part of the chapter compares the actual receipts, outlays, and deficit for 2003 with the current services estimates[2] shown in the 2003 Budget published in February 2002. This part also presents a more detailed comparison for mandatory and related programs, and reconciles the actual receipts, outlays, and deficit totals shown here with the figures for 2003 previously published by the Department of the Treasury.

Receipts

Receipts in 2003 were $1,782 billion, which is $339 billion less than the current services estimate of $2,121 billion in the 2003 Budget. As shown in Table 19–1, this shortfall was the net effect of legislative and administrative changes; economic conditions that differed from what had been expected; and technical factors that resulted in different collection patterns and effective tax rates than had been assumed.

Table 19–1. COMPARISON OF ACTUAL 2003 RECEIPTS WITH THE INITIAL CURRENT SERVICES ESTIMATES

(in billions of dollars)

	February 2002 estimate	Enacted legislation/ administrative actions	Different economic conditions	Technical factors	Net change	Actual
Individual income taxes	1,009	–33	–51	–131	–215	794
Corporation income taxes	208	–40	7	–44	–76	132
Social insurance and retirement receipts	750	–2	–13	–23	–37	713
Excise taxes	69	....	*	–2	–2	68
Estate and gift taxes	24	....	–*	–2	–2	22
Customs duties	21	–1	*	–*	–1	20
Miscellaneous receipts	40	....	–6	*	–6	35
Total	2,121	–76	–62	–201	–339	1,782

* $500 million or less.

Policy differences. The Job Creation and Worker Assistance Act, which was signed by President Bush on March 9, 2002, reduced 2003 receipts by $36 billion. Enactment of the Jobs and Growth Tax Relief Reconciliation Act in May 2003 reduced 2003 receipts by an additional $36 billion (see Chapter 16, "Federal Receipts" for a description of this Act). Other legislative and administrative changes reduced 2003 receipts by an additional $4 billion.

[1] These requirements, for receipts and "uncontrollable outlays," are in 31 USC 1105(a)(18) through (20).

[2] The current services concept is discussed in Chapter 24, "Current Services Estimates." For mandatory programs and receipts the February 2002 current services estimate is based on laws then in place. For discretionary programs the current services estimate is based on the current year estimates adjusted for inflation.

Economic differences. Differences between the economic assumptions upon which the current services estimates were based and actual economic performance accounted for a reduction in 2003 receipts of $62 billion. Lower-than-anticipated wages and salaries and other sources of personal income were in large part responsible for the reductions in individual income taxes and social insurance and retirement receipts of $51 billion and $13 billion, respectively. Lower-than-expected interest rates, which affect deposits of earnings by the Federal Reserve, were in large part responsible for the $6 billion reduction in miscellaneous receipts below the February 2002 estimate. These reductions were only partially offset by a $7 billion increase in corporation income taxes, attributable to higher-than-expected corporate profits.

Technical reestimates. Technical factors reduced 2003 receipts a net $201 billion below the February 2002 current services estimate. This net reduction was primarily attributable to lower-than-anticipated collections of individual and corporation income taxes of $131 billion and $44 billion, respectively. Lower-than-anticipated collections of social insurance and retirement receipts reduced 2003 receipts relative to the February 2002 estimate by an additional $23 billion. Lower effective tax rates on wages and salaries than estimated in February 2002 were primarily responsible for the net reductions in collections of individual income taxes and social insurance and retirement receipts. Different collection patterns and effective tax rates than assumed in February 2002 were primarily responsible for the lower-than-anticipated collections of corporation income taxes.

Outlays

Outlays for 2003 were $2,158 billion, $78 billion more than the $2,080 billion current services estimate in the 2003 Budget (February 2002).

Table 19–2 distributes the $78 billion net increase in outlays among discretionary and mandatory programs and net interest.[3] The table also makes rough estimates according to three reasons for the changes: policy; economic conditions; and technical estimating differences, a residual.

Policy changes are the result of legislative actions that change spending levels, primarily through higher or lower appropriations, which may reflect legislative responses to changed economic conditions, or changes in authorizing legislation. For 2003, policy changes increased outlays an estimated $132 billion relative to the initial current services estimates.

Policy changes increased discretionary outlays by $88 billion. Defense discretionary outlays increased by $70 billion and nondefense discretionary outlays increased by $18 billion, largely due to the 2003 Emergency Wartime Supplemental Appropriations Act. Policy changes increased mandatory outlays by $40 billion above current law. Farm income subsidies increased by $13 billion due to the Farm Security and Rural Investment Act of 2002 and the Consolidated Appropriations Act of 2003. Unemployment compensation outlays increased by another $13 billion due to the Job Creation and Worker Assistance Act of 2002 and the subsequent extensions of temporary extended unemployment compensation. The increase also includes outlays for temporary state fiscal relief totaling $9 billion, $4 billion for Medicaid and $5 billion for state fiscal assistance grants, resulting from enactment of the Jobs and Growth Tax Relief Reconciliation Act of 2003. The remaining $5 billion increase includes a $2 billion reduction in offsetting receipts from delaying spectrum auctions. Debt service costs increased by $4 billion due to outlay and revenue policy changes.

[3] Discretionary programs are controlled by annual appropriations, while mandatory programs are generally controlled by authorizing legislation. Mandatory programs are mostly formula benefit or entitlement programs with permanent spending authority that depend on eligibility criteria, benefit levels, and other factors.

Table 19–2. COMPARISON OF ACTUAL 2003 OUTLAYS WITH THE INITIAL CURRENT SERVICES ESTIMATES

(outlays in billions)

	Current Services (Feb. 2002)	Changes				Actual
		Policy	Economic	Technical	Total changes	
Discretionary:						
Defense	351	70	....	–16	54	405
Nondefense	409	18	....	–6	12	421
Subtotal, discretionary	759	88	....	–22	66	826
Mandatory:						
Social Security	472	....	–*	–1	–1	470
Other programs	674	40	*	–6	35	708
Subtotal, mandatory	1,145	40	–*	–7	34	1,179
Net interest	175	4	–28	3	–22	153
Total outlays	2,080	132	–29	–25	78	2,158

* $500 million or less.

Economic conditions that differed from those forecast in February 2002 resulted in a net decrease in outlays of $29 billion. This decrease almost entirely consists of a $28 billion decrease in net interest due to lower-than-expected interest rates.

Technical estimating differences and other changes resulted in a net decrease in outlays of $25 billion. Technical changes result from changes in such factors as the number of beneficiaries for entitlement programs, crop conditions, or other factors not associated with policy changes or economic conditions. Outlays for discretionary programs decreased an estimated $22 billion, largely due to slower-than-expected defense outlays. Outlays for mandatory programs decreased an estimated $7 billion. This reflects lower-than-anticipated outlays for Federal employee retirement and farm income subsidies, and downward subsidy reestimate of Export-Import Bank loans, partly offset by higher-than-anticipated outlays for Medicare. Net interest outlays increased by $3 billion largely due to higher deficits in 2002 and 2003 stemming from technical factors compared to the February 2002 estimates.

Surplus/Deficit

The preceding two sections discussed the differences between the initial current services estimates and the actual amounts of Federal Government receipts and outlays for 2003. This section combines these effects to show the net impact of these differences.

As shown in Table 19–3, the initial 2003 current services estimate was a surplus of $41 billion. The actual result was a deficit of $375 billion, a swing of $416 billion. Receipts were $339 billion less than the initial estimate and outlays were $78 billion more. The table shows the distribution of the changes according to the categories in the preceding two sections.

Table 19–3. COMPARISON OF THE ACTUAL 2003 DEFICIT WITH THE INITIAL CURRENT SERVICES ESTIMATE

(in billions)

	Current Services (Feb. 2002)	Changes				Actual
		Policy	Economic	Technical	Total changes	
Receipts	2,121	–76	–62	–201	–339	1,782
Outlays	2,080	132	–29	–25	78	2,158
Surplus/Deficit(-)	41	–207	–34	–175	–416	–375

Note: Surplus changes are receipts minus outlays. For these changes, a minus indicates a decrease in the surplus.

The net effect of policy changes for receipts and outlays reduced the surplus by $207 billion. Economic conditions that differed from the initial assumptions in February 2002 accounted for an estimated $34 billion decrease in the surplus. Technical factors further reduced the surplus by an estimated $175 billion.

Comparison of the Actual and Estimated Outlays for Mandatory and Related Programs for 2003

This section compares the original 2003 outlay estimates for mandatory and related programs under current law in the 2003 Budget (February 2002) with the actual outlays. Major examples of these programs include Social Security and Medicare benefits for the elderly, agricultural price support payments to farmers, and deposit insurance for banks and thrift institutions. This category also includes net interest outlays and undistributed offsetting receipts.

A number of factors may cause differences between the amounts estimated in the budget and the actual mandatory outlays. For example, legislation may change benefit rates or coverage; the actual number of beneficiaries may differ from the number estimated; or economic conditions (such as inflation or interest rates) may differ from what was assumed in making the original estimates.

Table 19–4. COMPARISON OF ACTUAL AND ESTIMATED OUTLAYS FOR MANDATORY AND RELATED PROGRAMS UNDER CURRENT LAW

(in billions of dollars)

	2003		
	Feb. 2002 estimate	Actual	Change
Mandatory outlays:			
Human resources programs:			
Education, training, employment, and social services	8	11	3
Health:			
Medicaid	159	161	2
Other	17	15	–2
Total health	175	175	–*
Medicare	229	246	17
Income security:			
Retirement and disability	93	91	–2
Unemployment compensation	41	54	14
Food and nutrition assistance	36	37	2
Other	100	100	–*
Total, income security	270	283	13
Social security	472	470	–1
Veterans benefits and services:			
Income security for veterans	28	29	2
Other	3	2	–*
Total veterans benefits and services	30	31	1
Total mandatory human resources programs	1,185	1,217	33
Other functions:			
Agriculture	12	17	5
International	–3	–7	–4
Deposit insurance	1	–1	–3
Other functions	8	7	–1
Total, other functions	19	16	–3
Undistributed offsetting receipts:			
Employer share, employee retirement	–50	–49	1
Rents and royalties on the outer continental shelf	–3	–5	–2
Other undistributed offsetting receipts	–5	....	5
Total undistributed offsetting receipts	–58	–54	3
Total, mandatory	1,145	1,179	34
Net interest:			
Interest on Treasury debt securities (gross)	348	318	–29
Interest received by trust funds	–161	–156	5
Other interest	–11	–9	2
Total net interest	175	153	–22
Total outlays for mandatory and net interest	1,320	1,332	11

* $500 million or less.

Table 19–4 shows the differences between the actual outlays for these programs in 2003 and the amounts originally estimated in the 2003 Budget, based on laws in effect at that time. Actual outlays for mandatory spending and net interest in 2003 were $1,332 billion, which was $11 billion more than the initial estimate of $1,320 billion, based on existing law in February 2002.

Actual outlays for mandatory human resources programs were $1,217 billion, $33 billion more than originally estimated. This increase was the net effect of legislative action, differences between actual and assumed economic conditions, differences between the anticipated and actual number of beneficiaries, and other technical differences.

Outlays for other functions were $3 billion less than originally estimated. Undistributed offsetting receipts were $3 billion less than expected, largely due to lower spectrum auction receipts.

Outlays for net interest were $153 billion, or $22 billion less than the original estimate. This decrease was the net effect of changes in interest rates from those initially assumed, changes in borrowing requirements due to differences in surpluses, and technical factors.

Reconciliation of Differences with Amounts Published by Treasury for 2003

Table 19–5 provides a reconciliation of the receipts, outlays, and deficit totals published by the Department of the Treasury in the September 2003 Monthly Treasury Statement and those published in this budget. The Department of the Treasury made adjustments to the estimates for the Combined Statement of Receipts, Outlays, and Balances, which decreased receipts by $202 million and increased outlays by $370 million. Additional adjustments for this budget increased receipts and outlays by $227 million and $731 million, respectively. The major changes were inclusion of the transactions of the United Mine Workers of America benefit funds and adjustments of the exchange stabilization fund principally to exclude gains and losses in the valuation of foreign currencies held in the fund.

Table 19–5. RECONCILIATION OF FINAL AMOUNTS FOR 2003

(in millions of dollars)

	Receipts	Outlays	Deficit
Totals published by Treasury (September MTS)	1,782,317	2,156,536	–374,219
Miscellaneous Treasury adjustments	–202	370	–572
Totals published by Treasury in U.S. Government Annual Report	1,782,115	2,156,906	–374,791
United Mine Workers of America benefit funds	190	190	
Exchange stabilization fund		484	–484
Other	37	57	–20
Total adjustments, net	227	731	–504
Totals in the budget	1,782,342	2,157,637	–375,295
MEMORANDUM:			
Total change since year-end statement	25	1,101	–1,076

PART II: HISTORICAL COMPARISON OF ACTUAL TO ESTIMATED SURPLUSES OR DEFICITS

This part of the chapter compares estimated surpluses or deficits to actual outcomes over the last two decades. The first section compares the estimate for the budget year of each budget with the subsequent actual result. The second section extends the comparison to the estimated surpluses or deficits for each year of the budget window—that is, for the current year through the fourth year following the budget year. This part concludes with some observations on the historical record of estimates of the surplus or deficit versus the subsequent actual outcomes.

Historical Comparison of Actual to Estimated Results for the Budget Year

Table 19–6 compares the estimated and actual surpluses or deficits since the deficit estimated for 1982 in the 1982 Budget. The estimated surpluses or deficits here for each budget include the Administration's policy proposals. Therefore, the original deficit estimate for 2003 differs from that shown in table 19–3, which is on a current services basis. Earlier comparisons of actual and estimated surpluses or deficits were on a policy basis, so for consistency the figures in Table 19–6 are on this basis.

On average, the estimates for the budget year underestimated actual deficits (or overestimated actual surpluses) by $26 billion over the 22-year period. Policy outcomes that differed from the original proposals increased the deficit by an average of $24 billion. Differences between economic assumptions and actual economic performance increased the deficit an average of $12 billion. Differences due to these two factors were partly offset by technical revisions, which reduced the deficit an average of $9 billion.

The relatively small average difference between actual and estimated deficits conceals a wide variation in the differences from budget to budget. The differences ranged from a $389 billion underestimate of the deficit to a $190 billion overestimate. The $389 billion underestimate, in the 2002 Budget, was due largely to receipt shortfalls associated with the 2001 recession and associated weak stock market performance. About a quarter of the underestimate was due to increased spending for recovery from the September 11, 2001 terrorist attacks, homeland security measures, and the war against terror, along with lower receipts due to the March 2002 economic stimulus act. The $190 billion overestimate of the deficit in the 1998 Budget stemmed largely from stronger-than-expected economic growth and a surge in individual income tax collections beyond that accounted for by economic factors.

Because the average deficit difference obscures the degree of under- and overestimation in the historical data, a more appropriate statistic to measure the magnitude of the differences is the average absolute difference. This statistic measures the difference without regard to whether it was an under- or overestimate. Since 1982, the average absolute difference has been $100 billion.

Another measure of variability is the standard deviation. This statistic measures the dispersion of the data around the average value. The standard deviation of the deficit differences since 1982 is $139 billion. Like the average absolute difference, this measure illustrates the high degree of variation in the difference between estimates and actual deficits.

The large variability in errors in estimates of the surplus or deficit for the budget year underscores the inherent uncertainties in estimating the future path of the Federal budget. Some estimating errors are unavoidable, because of differences between the President's original budget proposals and the legislation that Congress actually enacts. Occasionally such differences are huge, such as additional appropriations for disaster recovery, homeland security, and war efforts in response to the terrorist attacks of September 11, 2001, which were obviously not envisioned in the President's budget submitted the previous February. Even aside from differences in policy outcomes, errors in budget estimates can arise from new economic developments, unexpected changes in program costs, shifts in taxpayer behavior, and other factors. The budget impact of changes in economic assumptions is discussed further in Chapter 11 of this volume, "Economic Assumptions."

Five-Year Comparison of Actual to Estimated Surpluses or Deficits

The substantial differences between actual surpluses or deficits and the budget year estimates made less than two years earlier raises questions about the degree of variability for estimates of years beyond the budget year. Table 19–7 shows the summary statistics for the differences for the current year (CY), budget year (BY), and the four succeeding years (BY+1 through BY+4). These are the years that are required to be estimated in the budget by the Budget Enforcement Act of 1990.

On average, the budget estimates since 1982 overstated the deficit in the current year by $13 billion, but underestimated the deficit in the budget year by $26 billion. The budget estimates understated the deficit in the years following, by amounts growing from $50 billion for BY+1 to $60 billion for BY+4. While these results suggest a tendency to underestimate deficits toward the end of the budget horizon, the averages are not statistically different from zero in light of the high variation in the data.

The average absolute difference between estimated and actual deficits grows dramatically over the six years from CY through BY+4, from $48 billion in the

Table 19–6. COMPARISON OF ACTUAL AND ESTIMATED SURPLUSES OR DEFICITS SINCE 1982

(In billions of dollars)

Budget	Surplus or deficit (–) estimated for budget year[1]	Differences due to			Total difference	Actual surplus or deficit(–)
		Enacted legislation	Economic factors	Technical factors		
1982	–62	15	–70	–11	–66	–128
1983	–107	–12	–67	–22	–101	–208
1984	–203	–21	38	–	17	–185
1985	–195	–12	–17	12	–17	–212
1986	–180	–8	–27	–7	–41	–221
1987	–144	2	–16	8	–6	–150
1988	–111	–9	–19	–16	–44	–155
1989	–130	–22	10	–11	–23	–152
1990	–91	–21	–31	–79	–131	–221
1991	–63	21	–85	–143	–206	–269
1992	–281	–36	–21	48	–10	–290
1993	–350	–8	–13	115	95	–255
1994	–264	–8	16	52	61	–203
1995	–165	–18	1	18	1	–164
1996	–197	6	53	30	89	–107
1997	–140	1	–4	121	118	–22
1998	–121	–9	48	151	190	69
1999	10	–22	56	82	116	126
2000	117	–42	88	74	119	236
2001	184	–129	32	40	–57	127
2002	231	–103	–201	–85	–389	–158
2003	–80	–86	–34	–175	–295	–375
Average	....	–24	–12	9	–26	....
Absolute average[2]	....	28	43	59	100	....
Standard deviation	....	37	61	80	139	....

[1] Surplus or deficit estimate includes the effect of the budget's policy proposals.

[2] Absolute average is the average without regard to sign.

current year to $100 billion for the budget year, to $218 billion for BY+4. While under- and overestimates of the deficit have historically tended to average out, the absolute size of the under- or overestimates grows as the estimates extend further into the future. The standard deviation of the deficit differences shows the same pattern. The standard deviation grows from $62 billion for current year estimates to $139 billion for the budget year estimates and continues to increase steadily as the estimates extend further out, reaching $250 billion for BY+4.

The estimates of variability in the difference between estimated and actual deficits can be used to construct a range of uncertainty around a given set of estimates. Statistically, if these differences are normally distributed, the actual deficit will be within a range of two standard deviations above or below the estimate about 90% of the time. Chart 19–1 shows this range of uncertainty applied to the deficit estimates in this budget. This chart illustrates that unforeseen economic developments, policy outcomes, or other factors could give rise to large swings in the deficit estimates.

Table 19–7. DIFFERENCES BETWEEN ESTIMATED AND ACTUAL SURPLUSES OR DEFICITS FOR FIVE-YEAR BUDGET ESTIMATES SINCE 1982

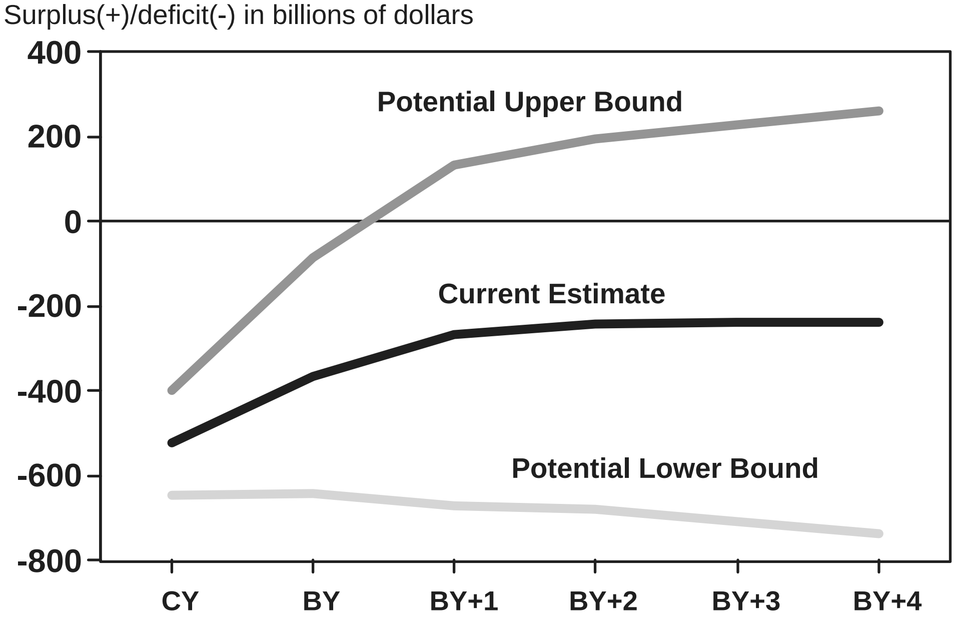
(In billions of dollars)

Measure	Current year estimate	Budget year estimate	Estimate for budget year plus			
			One year (BY+1)	Two years (BY+2)	Three years (BY+3)	Four years (BY+4)
Average difference [1]	13	–26	–50	–56	–68	–60
Average absolute difference [2]	48	100	145	178	203	218
Standard deviation	62	139	201	219	234	250

[1] A positive figure represents an underestimate of the surplus or an overestimate of the deficit.

[2] Average absolute difference is the average difference without regard to sign.

Chart 19-1. Illustrative Range of Budget Outcomes



20. OUTLAYS TO THE PUBLIC, NET AND GROSS

Table 20–1 shows net and gross outlays, and the relationship between them, for all major agencies. Outlays are the measure of Government spending. The budget records outlays when the Government makes payment for such things as Federal employee salaries, the purchase of supplies and equipment, grants to state and local government, and benefits to individuals. The Government's gross outlays are the sum of all these payments.

The outlay totals in the budget, however, whether for the Government as a whole or for agencies, programs, and functions (such as national defense), are net outlays, unless otherwise specified. Gross outlays, as the table shows, equal the net outlays plus offsetting receipts and collections from the public. Offsetting receipts and collections constitute the income the Government receives from its business-like enterprises and other market activities with the public, such as the proceeds from selling postage stamps, the fees charged for admittance to recreational areas, and the proceeds from selling land or natural resources. The budget refers to them as "offsetting," because they are subtracted from gross outlays rather than added to taxes and other collections from the public resulting from the exercise of the Government's sovereign or governmental powers to levy or impose taxes, fees, fines, and the like. The table shows that offsetting receipts and collections are relatively much more important for some agencies than for others.

The budget focuses on outlays that are net of receipts and collections from business-like activity, rather than combine these receipts and collections with taxes and other mandatory collections to maintain clear distinctions between the government's sovereign power and business-like transactions. The surplus or deficit is calculated by subtracting total outlays from total receipts. It would be exactly the same if offsetting collections and receipts were to be included in total receipts and not subtracted from gross outlays.

In this table, negative net outlays occur when collections exceed payments. The amounts for "Allowances" cover certain transactions that are expected to increase or decrease outlays but are not, for various reasons, attributed to any specific agency. The amounts labeled "undistributed offsetting receipts" are deducted from the Government-wide outlay totals but not from any specific agency. Chapter 5, "User Charges and Other Collections," in this volume discusses offsetting collections and receipts in more detail.

Table 20–1. TOTAL OUTLAYS, NET AND GROSS OF OFFSETTING COLLECTIONS AND RECEIPTS FROM THE PUBLIC, BY AGENCY, 2003–2005

(In millions of dollars)

Department or Other Unit	2003			2004			2005		
	Net Outlays	Offsetting Collections and Receipts from the Public	Outlays Gross of Collections and Receipts from the Public	Net Outlays	Offsetting Collections and Receipts from the Public	Outlays Gross of Collections and Receipts from the Public	Net Outlays	Offsetting Collections and Receipts from the Public	Outlays Gross of Collections and Receipts from the Public
Legislative Branch	3,427	72	3,499	4,269	75	4,344	4,373	74	4,447
Judicial Branch	5,123	28	5,151	5,306	34	5,340	5,903	36	5,939
Executive Branch									
Department of Agriculture	72,390	21,186	93,576	77,739	19,334	97,073	81,778	18,456	100,234
Department of Commerce	5,676	1,982	7,658	6,194	1,526	7,720	6,147	1,785	7,932
Department of Defense—Military	388,870	9,353	398,223	435,674	11,018	446,692	429,746	11,064	440,810
Department of Education	57,400	2,375	59,775	62,815	1,620	64,435	64,342	1,961	66,303
Department of Energy	19,385	6,053	25,438	20,623	6,620	27,243	22,496	6,411	28,907
Department of Health and Human Services	505,345	30,981	536,326	547,898	34,449	582,347	579,889	39,318	619,207
Department of Homeland Security	31,967	6,640	38,607	30,663	7,683	38,346	31,119	8,298	39,417
Department of Housing and Urban Development	37,474	2,896	40,370	46,177	1,816	47,993	38,943	1,400	40,343
Department of the Interior	9,210	3,808	13,018	9,965	4,231	14,196	9,784	5,043	14,827
Department of Justice	21,539	1,487	23,026	23,488	649	24,137	23,680	732	24,412
Department of Labor	69,593	1,498	71,091	59,949	2,618	62,567	56,995	3,018	60,013
Department of State	9,261	877	10,138	11,301	952	12,253	11,109	1,225	12,334
Department of Transportation	50,807	388	51,195	58,010	417	58,427	58,959	187	59,146
Department of the Treasury	366,987	14,956	381,943	368,981	16,602	385,583	395,200	17,079	412,279
Department of Veterans Affairs	56,887	4,729	61,616	60,318	6,352	66,670	67,314	4,731	72,045
Corps of Engineers-Civil Works	4,751	1,316	6,067	4,308	327	4,635	4,189	492	4,681
Other Defense Civil Programs	39,883	19	39,902	40,294	40	40,334	40,504	21	40,525
Environmental Protection Agency	8,061	822	8,883	8,129	190	8,319	8,277	219	8,496
Executive Office of the President	387	....	387	6,612	....	6,612	9,880	....	9,880

Table 20–1. TOTAL OUTLAYS, NET AND GROSS OF OFFSETTING COLLECTIONS AND RECEIPTS FROM THE PUBLIC, BY AGENCY, 2003–2005—Continued

(In millions of dollars)

Department or Other Unit	2003			2004			2005		
	Net Outlays	Offsetting Collections and Receipts from the Public	Outlays Gross of Collections and Receipts from the Public	Net Outlays	Offsetting Collections and Receipts from the Public	Outlays Gross of Collections and Receipts from the Public	Net Outlays	Offsetting Collections and Receipts from the Public	Outlays Gross of Collections and Receipts from the Public
General Services Administration	573	258	831	778	302	1,080	581	296	877
International Assistance Programs	13,462	12,377	25,839	17,365	13,403	30,768	16,597	11,852	28,449
National Aeronautics and Space Administration	14,552	329	14,881	14,604	101	14,705	16,386	101	16,487
National Science Foundation	4,736	....	4,736	5,346	....	5,346	5,586	....	5,586
Office of Personnel Management	54,136	8,951	63,087	57,568	9,937	67,505	60,880	10,696	71,576
Small Business Administration	1,558	443	2,001	3,978	325	4,303	683	83	766
Social Security Administration	507,733	6,265	513,998	530,495	7,614	538,109	554,271	7,952	562,223
Export-Import Bank of the United States	–3,249	3,913	664	–1,582	2,487	905	295	323	618
Federal Deposit Insurance Corporation	–733	1,655	922	–778	1,351	573	–833	1,153	320
Postal Service	–5,245	67,752	62,583	–4,956	67,916	63,020	–250	68,134	67,921
Railroad Retirement Board	3,056	2,489	5,545	3,781	1,893	5,674	4,692	1,099	5,791
Other Independent Agencies	13,084	10,392	23,400	14,930	11,295	26,165	13,502	11,914	25,379
Allowances	....	....	....	....	....	....	–767	....	–767
Undistributed Offsetting Receipts	–210,449	5,029	–205,420	–211,408	4,587	–206,821	–222,407	4,855	–217,552
Totals	**2,157,637**	**231,319**	**2,388,956**	**2,318,834**	**237,764**	**2,556,598**	**2,399,843**	**240,008**	**2,639,851**

21. TRUST FUNDS AND FEDERAL FUNDS

The budget consists of two major groups of funds: Federal funds and trust funds. This section presents summary information about the transactions of each of these two fund groups. Information is provided about the income and outgo of the major trust funds and a number of Federal funds that are financed by earmarked collections in a manner similar to trust funds. The effects on the Medicare trust funds and on Federal funds of the recently-enacted Medicare Prescription Drug, Improvement, and Modernization Act of 2003 are reflected in this chapter.

Federal Funds Group

The Federal funds group comprises the larger part of the budget. It includes all transactions not classified by law as being in trust funds.

The main financing component of the Federal funds group is the general fund, which is used to carry out the general purposes of Government rather than being restricted by law to a specific program. It consists of all collections not earmarked by law to finance other funds, including virtually all income taxes and many excise taxes, and all expenditures financed by these collections and by general Treasury borrowing.

Table 21–1. RECEIPTS, OUTLAYS, AND SURPLUS OR DEFICIT BY FUND GROUP

(In billions of dollars)

	2003 actual	Estimate					
		2004	2005	2006	2007	2008	2009
Receipts:							
Federal funds cash income:							
From the public	1,067.2	1,062.3	1,231.4	1,371.1	1,468.5	1,555.4	1,645.1
From trust funds	1.1	1.2	4.0	0.8	2.2	2.7	2.8
Total, Federal funds cash income	1,068.3	1,063.4	1,235.5	1,371.9	1,470.6	1,558.1	1,647.8
Trust funds cash income:							
From the public	801.1	827.9	894.3	955.3	1,010.3	1,056.7	1,104.7
From Federal funds:							
Interest	157.8	155.5	162.6	173.7	187.2	202.8	221.3
Other	185.7	215.5	242.7	292.4	313.1	333.5	352.6
Total, trust funds cash income	1,144.6	1,199.0	1,299.6	1,421.4	1,510.6	1,593.0	1,678.6
Offsetting receipts	–430.6	–464.3	–498.8	–587.7	–630.4	–665.9	–710.0
Total, unified budget receipts	1,782.3	1,798.1	2,036.3	2,205.7	2,350.8	2,485.3	2,616.4
Outlays:							
Federal funds cash outgo	1,622.0	1,772.1	1,842.4	1,918.5	2,007.8	2,117.5	2,223.1
Trust funds cash outgo	966.2	1,011.1	1,056.3	1,142.5	1,214.7	1,272.7	1,340.5
Offsetting receipts	–430.6	–464.3	–498.8	–587.7	–630.4	–665.9	–710.0
Total, unified budget outlays	2,157.6	2,318.8	2,399.8	2,473.3	2,592.1	2,724.3	2,853.5
Surplus or deficit (–):							
Federal funds	–553.7	–708.6	–606.9	–546.6	–537.1	–559.3	–575.2
Trust funds	178.4	187.9	243.3	279.0	295.8	320.4	338.2
Total, unified surplus/deficit (–)	–375.3	–520.7	–363.6	–267.6	–241.3	–239.0	–237.1

Note: Receipts include governmental, interfund, and proprietary receipts. They exclude intrafund receipts, which are offset against intrafund payments so that cash income and cash outgo are not overstated.

The Federal funds group also includes special funds and revolving funds, which earmark collections for spending on specific purposes. Where the law requires that Federal fund collections from a specified source be earmarked to finance a particular program, such as a portion of the Outer Continental Shelf mineral leasing receipts deposited into the Land and Water Conservation Fund, the collections and associated disbursements are recorded in special fund receipt and expenditure accounts. The majority of special fund collections are derived from the Government's power to impose taxes, fines, and other compulsory payments. They must be appropriated before they can be obligated and spent. However, significant amounts of collections credited to special funds are derived from business-like activity, such as the receipts from Outer Continental Shelf mineral leasing.

Revolving funds conduct continuing cycles of business-like activity. They charge for the sale of products or services and use the proceeds to finance their spending. Instead of being deposited in receipt accounts, their proceeds are recorded in the revolving funds, which are expenditure accounts. These collections generally are available automatically for obligation and making payments. Outlays for revolving funds are reported net of offsetting collections. There are two classes of revolving funds. Public enterprise funds, such as the Postal Service Fund, conduct business-like operations mainly with the public. Intragovernmental funds, such as the Federal Buildings Fund, conduct business-like operations mainly within and between Government agencies.

Trust Funds Group

The trust funds group consists of funds that are designated by law as trust funds. Like special funds and revolving funds, they earmark collections for spending on specific purposes. Many of the larger trust funds finance social insurance payments for individuals, such as Social Security, Medicare, and unemployment compensation. Other major trust funds finance military and Federal civilian employees' retirement, highway and transit construction, and airport and airway development. There are a few trust revolving funds that are credited with collections earmarked by law to carry out a cycle of business-type operations. Trust funds also include a few small funds established to carry out the terms of a conditional gift or bequest.

There is no substantive difference between trust funds and special funds or between revolving funds and trust revolving funds. Whether a particular fund is designated in law as a trust fund is, in many cases, arbitrary. For example, the National Service Life Insurance Fund is a trust fund, but the Servicemen's Group Life Insurance Fund is a Federal fund, even though both are financed by earmarked fees paid by veterans and both provide life insurance payments to veterans' beneficiaries.[1]

The Federal budget meaning of the term "trust" differs significantly from the private sector usage. The beneficiary of a private trust owns the trust's income and often its assets. A custodian manages the assets on behalf of the beneficiary according to the stipulations of the trust, which he or she cannot change unilaterally. In contrast, the Federal Government owns the assets and earnings of most Federal trust funds, and it can unilaterally raise or lower future trust fund collections and payments, or change the purpose for which the collections are used, by changing existing law. Only a few small Federal trust funds are managed pursuant to a trust agreement where the Government is the trustee, and the Government generally has some ability to determine the amount deposited into or paid out of these funds. Other amounts are held in deposit funds by the Government as a custodian on behalf of some entity outside the Government. The Government makes no decisions about the amount of these deposits or how they are spent. Therefore, they are considered to be non-budgetary instead of Federal trust funds and are excluded from the Federal budget.

A trust fund must use its income for the purposes designated by law. Some, such as the Federal Employees Health Benefits fund, spend their income almost as quickly as it is collected. Others, such as the Social Security and the Federal civilian employees retirement trust funds, currently spend considerably less than they collect each year. A surplus of income over outgo adds to the trust fund's balance, which is available to finance future expenditures. The balances are generally invested, by law, in Treasury securities.[2]

A trust fund normally consists of one or more receipt accounts (to record income) and an expenditure account (to record outgo). However, a few trust funds, such as the Veterans Special Life Insurance fund, are established by law as revolving funds. These funds are similar to revolving funds in the Federal funds group. They conduct a cycle of business-type operations, offsetting collections are credited to the funds (which are expenditure accounts), and their outlays are displayed net of the offsetting collections.

Income and Outgo by Fund Group

Table 21–1 shows income, outgo, and surplus or deficit by fund group and adds them together (and removes double-counting) to derive the total unified budget receipts, outlays, and surplus or deficit. The estimates assume enactment of the President's budget proposals. Income consists mostly of receipts (derived from governmental activity—primarily income, payroll, and excise taxes—and gifts). It also consists of offsetting receipts, which include proprietary receipts (derived from business-like transactions with the public) and interfund collections (receipts by one fund of payments from a fund in the other fund group) that are deposited in receipt accounts. Outgo consists of payments made to the public and/or to a fund in the other fund group.

[1] Another example is the Violent Crime Reduction Trust Fund, established pursuant to the Violent Crime Control and Law Enforcement Act of 1994. Because the Fund is substantively a means of accounting for general fund appropriations, and does not have any dedicated receipts, it is classified as a Federal fund rather than a trust fund, notwithstanding the presence of the words "Trust Fund" in its official name.

[2] The relationship between Treasury securities held by trust funds (and by other Government accounts), debt held the public, and gross Federal debt is discussed in Chapter 15, "Federal Borrowing and Debt."

Table 21–2. INCOME, OUTGO, AND BALANCES OF TRUST FUNDS GROUP

(In billions of dollars)

	2003 actual	Estimate					
		2004	2005	2006	2007	2008	2009
Total Trust Funds							
Balance, start of year	2,544.5	2,722.8	2,910.7	3,153.9	3,432.9	3,728.7	4,049.1
Income:							
Governmental receipts	758.3	780.7	844.3	886.5	932.9	974.6	1,017.6
Proprietary receipts	53.9	58.8	62.3	81.8	91.2	96.8	102.6
Receipts from Federal funds:							
Interest	157.8	155.5	162.6	173.7	187.2	202.8	221.3
Other	214.6	248.3	277.8	328.9	352.2	374.6	396.0
Subtotal, income	1,184.7	1,243.3	1,347.0	1,470.9	1,563.4	1,648.8	1,737.5
Outgo:							
To the public	1,005.2	1,054.3	1,099.7	1,191.1	1,265.4	1,325.7	1,396.6
Payments to Federal funds	1.1	1.2	4.0	0.8	2.2	2.7	2.8
Subtotal, outgo	1,006.3	1,055.5	1,103.7	1,191.9	1,267.6	1,328.4	1,399.3
Change in fund balance:							
Surplus or deficit (–):							
Excluding interest	20.5	32.4	80.7	105.3	108.7	117.6	116.8
Interest	157.8	155.5	162.6	173.7	187.2	202.8	221.3
Subtotal, surplus or deficit (–)	178.4	187.9	243.3	279.0	295.8	320.4	338.2
Adjustments:							
Transfers/lapses (net)	–*	–*	–0.1	....	....	....	....
Other adjustments	–*	*	*	....	....	....	....
Total, change in fund balance	178.4	187.9	243.2	279.0	295.8	320.4	338.2
Balance, end of year	2,722.8	2,910.7	3,153.9	3,432.9	3,728.7	4,049.1	4,387.3

* $50 million or less.

Two types of transactions are treated specially in the table. First, income and outgo for a fund group exclude transactions between funds within the same fund group.[3] These intrafund transactions constitute outgo and income for the individual funds that make and collect the payments. However, because the totals for each fund group measure its transactions with the public and the other fund group, intrafund transactions must be subtracted from the sum of the income and outgo of all individual funds within the fund group to calculate the consolidated income and outgo for that fund group as a whole. Second, income excludes the offsetting collections, which are offset against outgo in revolving fund expenditure accounts instead of being deposited in receipt accounts.[4] It would be conceptually appropriate to classify these collections as income, but at present the data are not tabulated centrally for both fund groups. Consequently, they are offset against outgo in Table 21–1 and are not shown separately.

Some funds in the Federal funds group and some trust funds are authorized to borrow from the general fund of the Treasury.[5] Borrowed funds are not recorded as receipts and are excluded from the income of the fund. The borrowed funds finance outlays by the fund in excess of available receipts. Subsequently, fund receipts are transferred from the fund to the general fund in repayment of the borrowing. The repayment is not recorded as an outlay of the fund or included in fund outgo.

Some income in both Federal funds and trust funds consists of offsetting receipts. In contrast, for most budget purposes, offsetting receipts are excluded from receipts figures and subtracted from gross outlays. There are two reasons for this treatment:

- *Business-like or market-oriented activities with the public:* The collections from such activities are deducted from gross outlays, rather than added to receipts, in order to produce budget totals for receipts and outlays that represent governmental rather than market activity.
- *Intragovernmental transactions:* Collections by one Government account from another are deducted from gross outlays, rather than added to receipts,

[3] For example, the railroad retirement trust funds pay the equivalent of social security benefits to railroad retirees, in addition to the regular railroad pension. These benefits are financed by a payment from the Federal Old-Age and Survivors Insurance trust fund to the railroad retirement trust funds. The payment and collection are both deducted so that total trust fund income and outgo measure disbursements to the public and to Federal funds.

[4] For example, postage stamp fees are deposited as offsetting collections in the Postal Service fund. As a result, the Fund's outgo is disbursements net of collections.

[5] For example, the Bonneville Power Administration Fund, a revolving fund in the Department of Energy, is authorized to borrow from the general fund, and the Black Lung Disability Trust Fund in the Department of Labor is authorized to receive appropriations of repayable advances from the general fund (a form of borrowing).

so that the budget totals measure the transactions of the Government with the public.

Because the income for Federal funds and for trust funds recorded in Table 21–1 includes offsetting receipts, those offsetting receipts must be deducted from the two fund groups' combined gross income in order to reconcile to total (net) unified budget receipts. Similarly, because the outgo for Federal funds and for trust funds in Table 21–1 consists of gross outlays, the amount of the offsetting receipts must be deducted from the sum of the Federal funds' and the trust funds' gross outgo in order to reconcile to total (net) unified budget outlays. Table 21–3 reconciles, for fiscal year 2003, the gross total of all trust fund and Federal fund receipts with the net total of the Federal fund group's and the trust fund group's cash income (as shown in Table 21–1), and with the unified budget's receipt total.

Table 21–3. RELATIONSHIP OF TOTAL FEDERAL FUND AND TRUST FUND RECEIPTS TO UNIFIED BUDGET RECEIPTS, FISCAL YEAR 2003

(In billions of dollars)

Gross trust fund receipts	1,167.8
Gross Federal fund receipts	1,097.6
Total of trust fund receipts and Federal fund receipts	2,265.4
Deduct intrafund receipts (from funds within the same fund group):	
Trust intrafund receipts	–23.2
Federal intrafund receipts	–29.2
Subtotal, intrafund receipts	–52.5
Total of trust funds cash income and Federal funds cash income	2,213.0
Deduct offsetting receipts: [1]	
Trust fund receipts from Federal funds:	
Interest in receipt accounts	–156.1
General fund payment to Medicare Part B	–80.9
Employing agencies' payments for pensions, Social Security, and Medicare	–41.2
General fund payments for unfunded liabilities of Federal employees retirement funds	–40.1
Transfer of taxation of Social Security benefits to OASDI, HI, and RRB	–22.7
Other receipts from Federal funds	–2.7
Subtotal, trust fund receipts from Federal funds	–343.6
Federal fund receipts from trust funds	–1.1
Proprietary receipts	–85.9
Subtotal, offsetting receipts	–430.6
Unified budget receipts	1,782.3

[1] Offsetting receipts are included in cash income for each fund group, but in the unified budget totals are excluded from the receipts total and instead deducted from outlays.

Income, Outgo, and Balances of Trust Funds

Table 21–2 shows, for the trust funds group as a whole, the funds' balance at the start of each year, income and outgo during the year, and the end of year balance. Income and outgo are divided between transactions with the public and transactions with Federal funds. Receipts from Federal funds are divided between interest and other interfund receipts.

The definition of income and outgo in this table differs from those in Table 21–1 in one important way. Trust fund collections that are offset against outgo (as offsetting collections) within expenditure accounts instead of being deposited in separate receipt accounts are classified as income in this table but not in Table 21–1. This classification is consistent with the definitions of income and outgo for trust funds used elsewhere in the budget. It has the effect of increasing both income and outgo by the amount of the offsetting collections. The difference was approximately $40 billion in 2003. Table 21–2, therefore, provides a more complete summary of trust fund income and outgo.

The trust funds group is expected to have large and growing surpluses over the projection period. As a consequence, trust fund balances are estimated to grow substantially, as they have over the past two decades. The size of the anticipated balances is unprecedented, and it results mainly from relatively recent changes in the way some trust funds are financed.

Primarily because of these changes, but also because of the impact of real growth and inflation, trust fund balances increased tenfold from 1982 to 2000, from $205 billion to $2.1 trillion. Under the proposals in the President's budget, the balances are estimated to double again by the year 2009, rising to $4.4 trillion. Almost all of these balances are invested in Treasury securities and earn interest. Therefore, they represent the value, in current dollars, of taxes and user fees that have been paid in advance for future benefits and services.

Until the 1980s, most trust funds operated on a pay-as-you-go basis. Taxes and user fees were set at levels high enough to finance benefits and administrative expenses, and to maintain prudent reserves, generally defined as being equal to one year's expenditures. As a result, trust fund balances tended to grow at about the same rate as their annual expenditures.

Pay-as-you-go financing was replaced in the 1980s by full or partial accrual funding for some of the larger trust funds. In order to partially prefund the social security benefits of the "baby-boomers", the Social Security Amendments of 1983 raised payroll taxes above the levels necessary to finance current expenditures. In 1984 a new system was set up to finance military retirement benefits on a full accrual basis. In 1986 full accrual funding of retirement benefits was mandated for Federal civilian employees hired after December 31, 1983. The latter two changes require Federal agencies and their employees to make annual payments to the Federal employees' retirement trust funds in an amount equal to the value of the retirement benefits earned by employees in that year. Since many years will pass before current employees are paid retirement benefits, the trust funds will accumulate substantial balances over time.

These balances are available to finance future benefit payments and other trust fund expenditures—but only in a bookkeeping sense. These funds are not set up to be pension funds, like the funds of private pension plans. The holdings of the trust funds are not assets of the Government as a whole that can be drawn down in the future to fund benefits. Instead, they are claims on the Treasury. When trust fund holdings are redeemed to pay benefits, Treasury will have to finance the expenditure in the same way as any other Federal expenditure: out of current receipts, by borrowing from the public, or by reducing benefits or other expenditures. The existence of large trust fund balances, therefore, does not, by itself, increase the Government's ability to pay benefits.

From an economic standpoint, the Government is able to prefund benefits only by increasing saving and investment in the economy as a whole. This can be fully accomplished only by simultaneously running trust fund surpluses equal to the actuarial present value of the accumulating benefits and not allowing the Federal fund deficit to increase, so that the trust fund surplus reduces a unified budget deficit or increases a unified budget surplus. This would reduce Federal borrowing by the amount of the trust funds surplus and increase the amount of national saving available to finance investment. Greater investment would increase future incomes and wealth, which would provide more real economic resources to support the benefits.

Table 21–4, on the CD-ROM included with this volume, shows estimates of income, outgo, and balances for 2003 through 2009 for the major trust funds. With the exception of transactions between trust funds, the data for the individual trust funds are conceptually the same as the data in Table 21–2 for the trust funds group. As explained previously, transactions between trust funds are shown as outgo of the fund that makes the payment and as income of the fund that collects it in the data for an individual trust fund, but the collections are offset against outgo in the data for the trust fund group. Additional information for these and other trust funds can be found in the Status of Funds tables in the Budget Appendix.

Table 21–5 (also on the CD-ROM) shows income, outgo, and balances of four existing Federal funds—two revolving funds and two special funds. It also shows a new special fund of the same general type established last year: a new fund for military retirees' health benefits. All these funds are similar to trust funds in that they are financed by earmarked receipts, excesses of income over outgo are invested, the interest earnings add to balances, and the balances remain available to finance future expenditures. The table is illustrative of the Federal funds group, which includes many other revolving funds and special funds in addition to the ones shown.

22. OFF-BUDGET FEDERAL ENTITIES AND NON-BUDGETARY ACTIVITIES

The unified budget of the Federal Government is divided by law between on-budget and off-budget entities. The off-budget Federal entities conduct programs that result in the same kind of spending and receipts as on-budget entities. Despite its off-budget classification, this spending channels economic resources toward particular uses in the same way as on-budget spending. Off-budget spending and receipts are discussed in the following section on off-budget Federal entities.

The budget does not include activities that are related to the Federal Government but that are non-budgetary by their inherent nature. In some cases this is because the activities are not conducted by the Government, such as the financial intermediation provided by the Government-sponsored enterprises; and in other cases this is because the activities are not costs to the Government itself, such as regulation. Nevertheless, some of these activities are important instruments of Federal policy. Some are discussed in the budget documents, and in certain cases the amounts involved are presented in conjunction with budget data. They are discussed in the section of this chapter on non-budgetary activities.

Table 22–1. COMPARISON OF TOTAL, ON-BUDGET, AND OFF-BUDGET TRANSACTIONS [1]

(In billions of dollars)

Fiscal Year	Receipts			Outlays			Surplus or deficit (–)		
	Total	On-budget	Off-budget	Total	On-budget	Off-budget	Total	On-budget	Off-budget
1975	279.1	216.6	62.5	332.3	271.9	60.4	–53.2	–55.3	2.0
1976	298.1	231.7	66.4	371.8	302.2	69.6	–73.7	–70.5	–3.2
TQ	81.2	63.2	18.0	96.0	76.6	19.4	–14.7	–13.3	–1.4
1977	355.6	278.7	76.8	409.2	328.5	80.7	–53.7	–49.8	–3.9
1978	399.6	314.2	85.4	458.7	369.1	89.7	–59.2	–54.9	–4.3
1979	463.3	365.3	98.0	504.0	404.1	100.0	–40.7	–38.7	–2.0
1980	517.1	403.9	113.2	590.9	476.6	114.3	–73.8	–72.7	–1.1
1981	599.3	469.1	130.2	678.2	543.0	135.2	–79.0	–73.9	–5.0
1982	617.8	474.3	143.5	745.7	594.3	151.4	–128.0	–120.0	–7.9
1983	600.6	453.2	147.3	808.4	661.3	147.1	–207.8	–208.0	0.2
1984	666.5	500.4	166.1	851.9	686.0	165.8	–185.4	–185.6	0.3
1985	734.1	547.9	186.2	946.4	769.6	176.8	–212.3	–221.7	9.4
1986	769.2	569.0	200.2	990.4	806.9	183.5	–221.2	–237.9	16.7
1987	854.4	641.0	213.4	1,004.1	810.2	193.8	–149.7	–169.3	19.6
1988	909.3	667.8	241.5	1,064.5	861.8	202.7	–155.2	–194.0	38.8
1989	991.2	727.5	263.7	1,143.6	932.7	210.9	–152.5	–205.2	52.8
1990	1,032.0	750.3	281.7	1,253.2	1,028.1	225.1	–221.2	–277.8	56.6
1991	1,055.0	761.2	293.9	1,324.4	1,082.7	241.7	–269.3	–321.5	52.2
1992	1,091.3	788.9	302.4	1,381.7	1,129.3	252.3	–290.4	–340.5	50.1
1993	1,154.4	842.5	311.9	1,409.5	1,142.9	266.6	–255.1	–300.4	45.3
1994	1,258.6	923.6	335.0	1,461.9	1,182.5	279.4	–203.3	–258.9	55.7
1995	1,351.8	1,000.8	351.1	1,515.8	1,227.1	288.7	–164.0	–226.4	62.4
1996	1,453.1	1,085.6	367.5	1,560.5	1,259.6	300.9	–107.5	–174.1	66.6
1997	1,579.3	1,187.3	392.0	1,601.3	1,290.6	310.6	–22.0	–103.3	81.4
1998	1,721.8	1,306.0	415.8	1,652.6	1,336.0	316.6	69.2	–30.0	99.2
1999	1,827.5	1,383.0	444.5	1,701.9	1,381.1	320.8	125.6	1.9	123.7
2000	2,025.2	1,544.6	480.6	1,788.8	1,458.0	330.8	236.4	86.6	149.8
2001	1,991.2	1,483.7	507.5	1,863.8	1,516.9	346.8	127.4	–33.3	160.7
2002	1,853.2	1,337.9	515.3	2,011.0	1,655.3	355.7	–157.8	–317.5	159.7
2003	1,782.3	1,258.5	523.8	2,157.6	1,794.6	363.0	–375.3	–536.1	160.8
2004 estimate	1,798.1	1,264.1	534.0	2,318.8	1,938.9	380.0	–520.7	–674.8	154.0
2005 estimate	2,036.3	1,461.2	575.1	2,399.8	2,004.1	395.7	–363.6	–542.9	179.4
2006 estimate	2,205.7	1,602.5	603.1	2,473.3	2,072.1	401.2	–267.6	–469.6	201.9
2007 estimate	2,350.8	1,714.5	636.3	2,592.1	2,180.4	411.7	–241.3	–465.9	224.6
2008 estimate	2,485.3	1,817.7	667.6	2,724.3	2,304.7	419.6	–239.0	–486.9	248.0
2009 estimate	2,616.4	1,917.5	698.9	2,853.5	2,418.0	435.5	–237.1	–500.5	263.4

[1] Off-budget transactions consist of the social security trust funds for all years and the Postal Service fund as of 1989.

Off-Budget Federal Entities

The Federal Government has used the unified budget concept as the foundation for its budgetary analysis and presentation since the 1969 budget. This concept was developed by the President's Commission on Budget Concepts in 1967. It calls for the budget to include all the Federal Government's programs and all the fiscal transactions of these programs with the public.

Every year since 1971, however, at least one Federal entity has been off-budget. Off-budget Federal entities are federally owned and controlled, but their transactions are excluded from the on-budget totals by law. When a Federal entity is off-budget, its receipts, outlays, and surplus or deficit are not included in the on-budget receipts, outlays, and surplus or deficit; and its budget authority is not included in the total budget authority for the on-budget Federal entities. The Budget Enforcement Act of 1990 excluded off-budget entities from general enforcement provisions (except for the administrative expenses of Social Security), although it had special enforcement provisions for Social Security.

The off-budget Federal entities conduct programs of the same type as the on-budget entities. Most of the tables in the budget documents include the on-budget and off-budget amounts both separately and in combination, or show them only as a total amount, in order to arrive at the unified budget totals that show Federal outlays and receipts comprehensively.

The off-budget Federal entities currently consist of the two Social Security trust funds, old-age and survivors insurance and disability insurance, and the Postal Service fund. Social Security was classified off-budget as of 1986 and the Postal Service fund in 1989. A number of other entities were off-budget at different times before 1986 but were classified on-budget by law in 1985 or earlier.

The preceding table divides the total Federal Government receipts, outlays, and surplus or deficit between the on-budget and off-budget amounts. Within this table Social Security is classified as off-budget for all years, in order to provide consistent comparison over time. The much smaller Postal Service transactions are classified as off-budget starting in 1989. Entities that were off-budget at one time but are now on-budget are classified as on-budget for all years.

The off-budget entities are a significant part of total Federal spending and receipts. In 2005, the off-budget receipts are an estimated 28 percent of total receipts, and the off-budget outlays are a somewhat smaller percentage of the total. The estimated unified budget deficit in that year is $364 billion—a $543 billion on-budget deficit partly offset by a $179 billion off-budget surplus. The off-budget surplus is virtually the same as the Social Security surplus. Social Security had a deficit in the latter 1970s and early 1980s, but since the middle 1980s it has had a large and growing surplus. This surplus is expected to continue to grow throughout the period of this table and for some years thereafter. However, it is estimated to subsequently decline, turn into a deficit, and never reach balance again under present law. The long-term challenge of Social Security is addressed in a chapter of the main budget volume, "Ensuring Fiscal Responsibility," and in chapter 12 of this volume, "Stewardship."

Non-Budgetary Activities

Federal credit: budgetary and non-budgetary transactions.—The Federal Credit Reform Act of 1990 refined budget concepts by distinguishing between the costs of credit programs, which are budgetary in nature, and the other transactions of credit programs, which are not. For 1992 and subsequent years, the costs of direct loans and loan guarantees are calculated as the present value of estimated cash outflows from the Government less the present value of estimated cash inflows to the Government. These costs are equivalent to the outlays of other Federal programs and are included in the budget as outlays of credit program accounts when the Federal Government makes a direct loan or guarantees a private loan.

The complete cash transactions with the public—the disbursement and repayment of loans, the payment of default claims on guarantees, the collection of interest and fees, and so forth—are recorded in separate financing accounts. The financing accounts also receive payments from the credit program accounts for the costs of direct loans and loan guarantees. The net transactions of the financing accounts—i.e., the cash transactions with the public less the amounts received from the program accounts—are not costs to the Government. Therefore, the net transactions of the financing accounts are non-budgetary in concept, and the Act excludes them from the budget.[1] Because they are non-budgetary in concept, they are not classified as off-budget Federal entities. Transactions in the financing accounts do affect the Government's borrowing requirement, as explained in chapter 15 of this volume, "Federal Borrowing and Debt."

The budget outlays of credit programs thus measure the cost of Government credit decisions, and they record this cost when the credit assistance is provided. This enables the budget to more effectively fulfill its purpose of being a financial plan for allocating resources among alternative uses: comparing the cost of a program with its benefits, comparing the cost of credit programs with the cost of other spending programs, and comparing the cost of one type of credit assistance with the cost of another type.[2]

Credit programs are discussed in chapter 7 of this volume, "Credit and Insurance."

[1] See sec. 505(b) of the Act.

[2] For more explanation of the budget concepts for direct loans and loan guarantees, see the sections on Federal credit and credit financing accounts in chapter 25 of this volume, "The Budget System and Concepts." The structure of credit reform is further explained in chapter VIII.A of the Budget of the United States Government, Fiscal Year 1992, Part Two, pp. 223–26. The implementation of credit reform through 1995 is reviewed in chapter 8, "Underwriting Federal Credit and Insurance," Analytical Perspectives, Budget of the United States Government, Fiscal Year 1997, pp. 142–44. Refinements and simplifications enacted by the Balanced Budget Act of 1997 or provided by later OMB guidance are explained in chapter 9, "Underwriting Federal Credit and Insurance," Analytical Perspectives, Budget of the United States Government, Fiscal Year 1999, p. 170.

Deposit funds.—Deposit funds are non-budgetary accounts that record amounts held by the Government temporarily until ownership is determined (such as earnest money paid by bidders for mineral leases) or held by the Government as an agent for others (such as state income taxes withheld from Federal employees' salaries and not yet paid to the states). The largest deposit fund is the Thrift Savings Fund, which holds stocks and bonds as an agent for Federal employees who participate in the Thrift Savings Plan, a defined contribution retirement plan. Because these assets are the property of the employees and are held by the Government in a fiduciary capacity, the transactions of the fund are not transactions of the Government itself and therefore are non-budgetary in concept. The administrative costs and the transactions of budgetary accounts with the fund are included in the budget. For similar reasons, the budget excludes funds that are owned by Indian tribes and held and managed by the Government in a fiduciary capacity on the tribes' behalf. Deposit funds are further discussed in a section of chapter 25 of this volume, "The Budget System and Concepts."

Taxation and tax expenditures.—Taxation provides the Government with income, which is included in the budget as "receipts," and which withdraws purchasing power from the private sector to finance Government expenditures. In addition to this primary economic effect, taxation has important effects on the incentives that affect the allocation of resources among private uses and the distribution of income among individuals. These effects depend on the composition of the Federal tax system and the rates and other structural characteristics of each Federal tax. The latter effects of taxation on resource allocation and income distribution are in many ways analogous to the effects of outlays, but these effects are not recorded as budget outlays nor are they measured by budget receipts.

Some of the effects of taxes on resource allocation and income distribution, but not all, arise from special exclusions, exemptions, deductions, and similar provisions that are identified by comparing the tax law with a baseline. Revenue losses caused by these special provisions are defined as "tax expenditures" and are discussed in chapter 18 of this volume, "Tax Expenditures." The chapter includes tables with estimates for tax expenditures associated with the individual and corporation income taxes. The chapter also compares tax expenditures with spending programs and regulation as alternative methods for achieving policy objectives, and it provides an illustrative overview of performance measures that might be used to evaluate tax expenditures.

The baseline concepts used to identify and measure tax expenditures in chapter 18 have important ambiguities. Although partly patterned on a comprehensive income tax, they are subjective, as explained in the tax expenditure chapter for this year and the past two years, and are thus open to question in a number of respects. The Treasury Department has therefore begun a review of the tax expenditure presentation. The appendix to chapter 18 provides an initial review, focusing on three issues: (1) using a comprehensive income tax as a baseline, (2) including negative tax expenditures in the presentation (i.e., provisions that cause people to pay more tax than they would under a baseline—such as the failure to adjust interest, capital gains, and depreciation for inflation in comparison to a comprehensive income tax), and (3) using a comprehensive consumption tax as a baseline.

Government-sponsored enterprises.—The Federal Government has established a number of Government-sponsored enterprises, such as Fannie Mae, Freddie Mac, and the Farm Credit Banks, to provide financial intermediation for specified public purposes. They are excluded from the budget because they are privately owned and controlled. However, primarily because they were established by the Federal Government for public-policy purposes, estimates of their activities are reported in a separate chapter of the budget Appendix, their activities are analyzed in chapter 7 of this volume, "Credit and Insurance," and their lending and borrowing are summarized in table 7–9 of that chapter.

Regulation.—Some types of regulation have economic effects that are similar to budget outlays or tax expenditures by requiring the private sector to make expenditures for specified purposes, such as safety and pollution control. The regulatory planning process is described annually in *The Regulatory Plan and the Unified Agenda of Federal Regulatory and Deregulatory Actions*.[3]

The Office of Management and Budget began to publish a report on the costs and benefits of Federal regulation in 1997. The latest report, *Informing Regulatory Decisions,* was released in September 2003 and includes a report on unfunded mandates.[4] The report estimates the total costs and benefits of major Federal regulations reviewed by OMB from October 1992 through September 2002 and the impact of Federal regulation on state, local, and tribal governments. It also provides a status report on specific regulatory reforms nominated by members of the public; analyzes the way in which the government manages emerging risks; and includes the new OMB Circular No. A–4, which provides guidance to Federal agencies on the development of regulatory analysis. The report is required by statute to be updated annually.

[3] The most recent publication was issued by the Regulatory Information Service Center in December 2003 and printed in the Federal Register of December 22, 2003 (vol. 68, no. 245).

[4] Office of Information and Regulatory Affairs, Office of Management and Budget, Informing Regulatory Decisions: 2003, Report to Congress on the Costs and Benefits of Regulations and Unfunded Mandates on State, Local, and Tribal Entities (2003).

23. FEDERAL EMPLOYMENT AND COMPENSATION

This section provides information on civilian and military employment in the Executive, Legislative, and Judicial branches. It also provides information on personnel compensation and benefits.

Measuring Federal Employment

Civilian employment is measured on the basis of full-time equivalents (FTEs). One FTE is equal to one work year (see OMB Circular A–11, Section 32). Put simply, one full-time employee counts as one FTE, and two half-time employees also count as one FTE. Data shown for military personnel are average strengths, not FTEs. Military average strength is calculated by averaging the monthly military personnel totals within a fiscal year. Tables 23–1 and 23–3 show FTE data, while Table 23–2 shows end strength or "positions filled" data as of September 30th.

Full-time equivalent data for the Department of Homeland Security FTEs is provided on a three-year comparable basis from 2003 to 2005. Agencies that transferred FTEs to DHS (e.g., Justice, Transportation, etc.) are also shown on a three-year comparable basis.

As seen in Table 23–1, FTE data for the Office of Personnel Management (OPM) shows a 75 percent increase between 2001 and 2005. These estimates reflect a proposed transfer of DoD's Defense Security Service activities beginning in 2004 and completed in 2005. This transfer is subject to change. No decision has been made at this time for any transfer of functions and employees however.

Table 23–3 shows a decrease of approximately 100 thousand military in the Department of Defense between 2004 and 2005. This drop in the estimate is expected as DOD normalizes its current over-manned status. This will include the separation of Service members currently prevented from separating due to DoD's "Stop Loss" policy.

Personnel Compensation and Benefits

Table 23–4 displays personnel compensation and benefits (in millions of dollars) for all branches of Government, to include military personnel.

Direct compensation of the Federal work force includes base pay and premium pay, such as overtime. In addition, it includes other cash components, such as geographic pay differentials (i.e., locality pay, and special pay adjustments for law enforcement officers), recruitment and relocation bonuses, retention allowances, performance awards, and cost-of-living and overseas allowances.

In the case of military personnel, compensation includes basic pay, special and incentive pays (including enlistment and reenlistment bonuses), and allowances for clothing, housing, and subsistence.

Table 23–4 shows an approximately $5 billion increase in DoD military direct compensation in 2004 attributed to a supplemental wartime appropriation. This increase was required to compensate the large number of reservists called to active duty in support of operations in Iraq and Afghanistan.

Related compensation in the form of personnel benefits for current employees consists of the cost to Government agencies (as an employer) primarily for health insurance, life insurance, Social Security (old age, survivors, disability, and health insurance) and contributions to the retirement funds to finance future retirement benefits. Compensation for former personnel includes outlays for retirement pay benefits, and the Government's share of the cost of health and life insurance.

Table 23–1. FEDERAL EMPLOYMENT IN THE EXECUTIVE BRANCH

(Civilian employment as measured by Full-Time Equivalents, in thousands)

Agency	Actual			Estimate		Change: 2001 to 2005	
	2001	2002	2003	2004	2005	FTE's	Percent
Cabinet agencies:							
Agriculture	96.9	97.0	101.4	101.7	99.0	2.1	2.2%
Commerce	36.7	34.9	34.5	36.1	38.2	1.5	4.1%
Defense-military functions	649.9	649.9	648.9	647.8	650.7	0.8	0.1%
Education	4.6	4.5	4.5	4.5	4.5	–0.1	–2.2%
Energy	15.6	15.8	15.6	16.1	15.9	0.3	1.9%
Health and Human Services	61.8	59.0	60.0	61.6	61.8	....	0.0%
Homeland Security[1]	....	81.3	144.5	144.0	145.1	n/a	n/a
Housing and Urban Development	10.1	10.0	10.4	10.6	10.5	0.4	4.0%
Interior	68.7	70.3	71.0	71.4	71.9	3.2	4.7%
Justice	124.2	97.3	99.4	112.6	116.5	–7.7	–6.2%
Labor	16.5	17.0	16.9	17.3	17.4	0.9	5.5%
State	27.7	28.6	29.5	30.3	30.9	3.2	11.6%
Transportation	63.4	61.2	59.0	58.5	58.6	–4.8	–7.6%
Treasury	145.0	115.9	115.4	115.9	118.4	–26.6	–18.3%
Veterans Affairs	206.9	208.9	211.8	218.3	219.7	12.8	6.2%
Other agencies—excluding Postal Service:							
Agency for International Development	2.3	2.4	2.3	2.4	2.6	0.3	13.0%
Broadcasting Board of Governors	2.4	2.4	2.4	2.3	2.5	0.1	4.2%
Corps of Engineers—Civil Works	24.7	25.0	24.5	24.8	24.8	0.1	0.4%
Environmental Protection Agency	17.5	17.5	17.5	17.6	17.6	0.1	0.6%
EEOC	2.7	2.8	2.6	2.5	2.6	–0.1	–3.7%
FDIC/RTC	6.4	6.0	5.4	5.6	5.5	–0.9	–14.1%
FEMA[2]	4.9	....	....	....	....	n/a	n/a
General Services Administration	14.0	12.4	12.9	12.5	12.5	–1.5	–10.7%
NASA	18.7	18.7	18.7	18.9	19.4	0.7	3.7%
National Archives and Records Administration	2.6	2.8	2.8	2.9	2.9	0.3	11.5%
National Labor Relations Board	2.0	1.9	1.9	1.9	1.9	–0.1	–5.0%
National Science Foundation	1.2	1.2	1.2	1.3	1.3	0.1	8.3%
Nuclear Regulatory Commission	2.8	2.8	2.9	3.1	3.1	0.3	10.7%
Office of Personnel Management[3]	2.8	2.8	2.8	3.9	4.9	2.1	75.0%
Peace Corps	1.0	1.0	1.0	1.2	1.3	0.3	30.0%
Railroad Retirement Board	1.2	1.2	1.1	1.1	1.0	–0.2	16.7%
Securities and Exchange Commission	2.9	3.0	3.1	3.6	3.9	1.0	34.5%
Small Business Administration	4.1	4.0	3.8	3.9	3.9	–0.2	–4.9%
Smithsonian Institution	4.9	5.0	5.2	5.8	6.0	1.1	22.4%
Social Security Administration	62.7	63.1	63.1	65.0	68.7	6.0	9.6%
Tennessee Valley Authority	13.2	13.5	13.1	13.2	13.2	....	0.0%
All other small agencies	14.7	15.0	15.1	15.9	15.8	1.1	7.5%
Total, Executive Branch civilian employment[4]	**1,737.8**	**1,755.9**	**1,826.2**	**1,856.1**	**1,874.5**	**136.7**	**7.9%**
Subtotal, Defense	649.9	649.9	648.9	647.8	650.7	0.8	0.1%
Subtotal, Non-Defense	1,087.9	1,106.1	1,177.3	1,208.3	1,223.9	136.0	12.5%

[1] Data is not comparable for all years because Department of Homeland Security FTEs are shown on a three-year comparable basis starting in 2003.

[2] FEMA realigned under the Department of Homeland Security.

[3] Aproximately 900 FTE realigned to OPM from the Defense Investigative Service in FY 2003 and 1,800 in FY 2004.

[4] Totals may not add due to rounding.

Table 23–2. TOTAL FEDERAL EMPLOYMENT

(As measured by total positions filled)

Description	Actual as of September 30			Change: 2001 to 2003	
	2001	2002	2003	Positions	Percent
Executive branch civilian employment:					
All agencies except Postal Service and Postal Rate Commission:					
Full-time permanent	1,595,801	1,632,663	1,646,688	50,887	3.2%
Other than full-time permanent	196,009	185,597	220,288	24,279	12.4%
Subtotal	1,791,810	1,818,260	1,866,976	75,166	4.2%
Postal Service: [1]					
full-time permanent	661,452	645,758	634,709	–26,743	–4.0%
Other than full-time permanent	186,418	165,933	164,539	–21,879	11.7%
Subtotal	847,870	811,691	799,248	–48,622	–5.7%
Subtotal, Executive branch civilian employment	2,639,680	2,629,951	2,666,224	26,544	1.0%
Military personnel on active duty: [2]					
Department of Defense	1,385,116	1,411,634	1,434,377	49,261	3.6%
Department of Transportation (Coast Guard)	36,580	38,238	37,472	892	2.4%
Commissioned Corps (PHS, NOAA)	6,027	6,221	6,200	173	2.9%
Subtotal, military personnel	1,427,723	1,456,093	1,478,049	50,326	3.5%
Subtotal, Executive Branch	4,067,403	4,086,044	4,144,273	76,870	1.9%
Legislative branch:					
full-time permanent	11,856	12,097	12,044	188	1.6%
Other than full-time permanent	18,583	18,789	19,070	487	2.6%
Subtotal, Legislative Branch	30,439	30,886	31,114	675	2.2%
Judicial Branch:					
Full-time permanent	30,478	31,286	30,955	477	1.6%
Other than full-time permanent	3,332	3,413	3,304	–28	–0.8%
Subtotal, Judicial Branch	33,810	34,699	34,259	499	1.5%
Grand total [3]	**4,131,652**	**4,151,629**	**4,209,646**	**77,994**	**1.9%**
ADDENDUM					
Executive branch civilian personnel (excluding Postal Service):					
DOD civilians - Military functions	647,048	644,817	636,454	–10,594	–1.6%
All other executive branch	1,144,762	1,173,443	1,230,522	85,760	7.5%
Total	**1,791,810**	**1,818,260**	**1,866,976**	**75,166**	**4.2%**

[1] Includes Postal Rate Commission.
[2] Excludes reserve components.
[3] Includes Summer Aides, Stay-in-school, Junior Fellowship, Worker-Trainee Opportunity, and disadvantage youth programs.

Table 23–3. TOTAL FEDERAL EMPLOYMENT

(As measured by Full-Time Equivalents)

Description	2003 Actual	Estimate		Change: 2003 to 2005	
		2004	2005	FTE's	Percent
Executive branch civilian personnel:					
All agencies except Postal Service and Defense	1,177,270	1,208,297	1,223,875	46,605	4.0%
Defense-Military functions (civilians)	648,891	647,807	650,665	1,774	0.3%
Subtotal, excluding Postal Service	1,826,161	1,856,104	1,874,540	48,379	2.6%
Postal Service [1]	777,928	773,958	759,244	–18,684	–2.4%
Subtotal, Executive Branch civilian personnel	2,604,089	2,630,062	2,633,784	29,695	1.1%
Executive branch uniformed personnel: [2]					
Department of Defense	1,496,030	1,466,900	1,392,000	–104,030	–7.0%
Department of Transportation (Coast Guard)	39,219	39,874	40,259	1,040	2.7%
Commissioned Corps	6,548	6,688	6,695	147	2.2%
Subtotal, uniformed military personnel	1,541,797	1,513,462	1,438,954	–102,843	–6.7
Subtotal, Executive Branch	4,145,886	4,143,524	4,072,738	–73,148	–1.8%
Legislative Branch: [3] Total FTE [3]	32,080	32,385	32,813	733	2.3%
Judicial branch: Total FTE	33,568	33,417	34,502	934	2.8%
Grand total	**4,211,534**	**4,209,326**	**4,140,053**	–71,481	–1.7%

[1] Includes Postal Rate Commission.

[2] Military personnel on active duty. Excludes reserve components. Data shown for military are average strengths, not FTEs.

[3] Actual 2002 FTE data not available for the Senate (positions filled were used).

TABLE 23–4. PERSONNEL COMPENSATION AND BENEFITS

(In millions of dollars)

Description	2003 Actual	2004 Estimate	2005 Request	Change: 2003 to 2005	
				Dollars	Percent
Civilian personnel costs:					
Executive Branch (excluding Postal Service):					
Direct compensation:					
DOD—military functions	37,006	37,569	38,575	1,569	4.2%
All other executive branch	75,132	80,860	84,873	9,741	13.0%
Subtotal, direct compensation	112,138	118,429	123,448	11,310	10.1%
Personnel benefits:					
DOD—military functions	9,287	9,603	10,712	1,425	15.3%
All other executive branch	29,980	31,878	32,821	2,841	9.5%
Subtotal, personnel benefits	39,267	41,481	43,533	4,266	10.9%
Subtotal, executive branch	151,405	159,910	166,981	15,576	10.3%
Postal Service:					
Direct compensation	37,145	38,260	38,612	1,467	3.9%
Personnel benefits	12,079	12,643	13,215	1,136	9.4%
Subtotal	49,224	50,903	51,827	2,603	5.3%
Legislative Branch: [1]					
Direct compensation	1,638	1,752	1,850	212	12.9%
Personnel benefits	411	465	489	78	19.0%
Subtotal	2,049	2,217	2,339	290	14.2%
Judicial Branch:					
Direct compensation	2,341	2,475	2,683	342	14.6%
Personnel benefits	636	660	756	120	18.9%
Subtotal	2,977	3,135	3,439	462	15.5%
Total, civilian personnel costs	205,655	216,165	224,586	18,931	9.2%
Military personnel costs:					
DOD—Military Functions:					
Direct compensation	71,868	77,344	68,461	–3,407	–4.7%
Personnel benefits	32,023	36,101	34,655	2,632	8.2%
Subtotal	103,891	113,445	103,116	–775	–0.7%
All other executive branch, uniformed personnel:					
Direct compensation	2,175	2,297	2,487	312	14.3%
Personnel benefits	515	560	633	118	22.9%
Subtotal	2,690	2,857	3,120	430	16.0%
Total, military personnel costs [2]	106,581	116,302	106,236	–345	–0.3%
Grand total, personnel costs [3]	**312,236**	**332,467**	**330,822**	18,586	**6.0%**
ADDENDUM					
Former Civilian Personnel:					
Retired pay for former personnel	51,405	54,002	56,171	4,766	9.3%
Government payment for Annuitants:					
Employee health benefits	6,674	7,358	8,046	1,372	20.6%
Employee life insurance	34	35	35	1	2.9%
Total Former Civilian Personnel	....	....	....	....	....
Former Military personnel:					
Retired pay for former personnel	35,396	37,182	38,333	2,937	8.3%
Military annuitants health benefits	4,583.00	4,903.00	5,283	700	15.3%

[1] Excludes members and officers of the Senate.

[2] Excludes reserve components not on active duty.

[3] Senior Executive Service (SES) compensation levels are still unsettled.

CURRENT SERVICES ESTIMATES

24. CURRENT SERVICES ESTIMATES

There has long been a desire to have a neutral benchmark against which policy proposals can be measured. Since the early 1970s when the first requirements for the calculation of a "current services" baseline were enacted, a variety of concepts and measures have been employed. In recent years, the current services baseline has been defined to be identical to the baseline required by the Budget Enforcement Act (BEA). However, that baseline has some serious technical flaws, which compromise its ability to serve as a neutral measure. This section provides detailed estimates of a baseline that correct these flaws. It also discusses alternative formulations for the baseline.

Ideally, a current services baseline would provide a projection of estimated receipts, outlays, deficits or surpluses, and budget authority needed to reflect this year's enacted policies and programs for each year in the future. Because such a concept would be nearly impossible to calculate across all segments of the government, the baseline has become largely a mechanical construct. The following section discusses the construct as it applies to different types of programs. The baseline is not intended to be a prediction of the final outcome of the annual budget process, nor is it a proposed budget. By itself, the current services baseline commits no one to any particular policy, and it does not constrain the choices available. The commitments or constraints reflected in the current services estimates are based on the tax and spending policies contained in current law.

The current services baseline is used in a variety of ways: It can warn of future problems, either for Government fiscal policy as a whole or for individual tax and spending programs. It provides a starting point for formulating the annual budget. It is a "policy-neutral" benchmark against which the President's Budget and other budget proposals can be compared to see the magnitude of the proposed changes. The following table shows current services estimates of receipts, outlays, and surpluses for 2003 through 2009. They are based on the economic assumptions described later in this chapter. The estimates are shown on a unified budget basis. The off-budget receipts and outlays of the Social Security trust funds and the Postal Service Fund are added to the on-budget receipts and outlays to calculate the unified budget totals. The table also shows the current services estimates by major component. The BEA baseline deficits are shown as a memorandum in the table.

Table 24–1. BASELINE CATEGORY TOTALS

(In billions of dollars)

	2003	2004	2005	2006	2007	2008	2009
Receipts	1,782.3	1,791.2	2,036.6	2,214.9	2,353.7	2,497.1	2,635.6
Outlays:							
Discretionary:							
Defense	404.9	451.6	438.8	417.3	420.8	432.9	442.8
Nondefense	420.8	456.6	470.8	467.6	475.4	481.1	489.7
Subtotal, discretionary	825.7	908.2	909.6	884.9	896.2	914.1	932.5
Mandatory:							
Social Security	470.5	492.0	510.5	529.1	552.0	576.6	608.1
Medicare	245.7	265.9	289.6	336.4	372.1	393.4	417.7
Medicaid and SCHIP	165.0	182.3	188.5	198.4	214.0	232.7	252.5
Other mandatory	297.6	314.0	320.5	305.8	302.8	324.7	339.3
Subtotal, mandatory	1,178.9	1,254.2	1,309.1	1,369.7	1,440.9	1,527.5	1,617.6
Net interest	153.1	156.3	178.0	213.2	245.5	273.1	296.4
Total outlays	2,157.6	2,318.7	2,396.7	2,467.7	2,582.5	2,714.7	2,846.6
Unified deficit	–375.3	–527.5	–360.1	–252.9	–228.9	–217.5	–211.0
On-budget	–536.1	–681.5	–538.9	–454.8	–453.1	–464.9	–473.7
Off-budget	160.8	154.0	178.8	201.9	224.2	247.4	262.7
Memorandum:							
BEA baseline deficit	–375.3	–527.5	–393.3	–305.3	–291.8	–287.8	–270.9
Correct growth rates for pay	....	....	1.8	2.2	2.3	2.4	2.5
Do not extend emergencies	....	....	42.8	78.5	86.3	89.3	91.5
Extend certain tax provisions	....	....	–11.8	–30.3	–30.5	–29.7	–45.8
Related debt service	....	....	0.4	2.0	4.7	8.2	11.6
Current baseline deficit	–375.3	–527.5	–360.1	–252.8	–228.9	–217.5	–211.0

Conceptual Basis for Estimates

Receipts and outlays are divided into two categories that are important for calculating the current services estimates: those controlled by authorizing legislation (direct spending and receipts) and those controlled through the annual appropriations process (discretionary spending). Different estimating rules apply to each category. There are numerous alternative rules that could be used to develop current services. The next section discusses some alternatives that might be considered.

Direct spending and receipts.—Direct spending includes the major entitlement programs, such as social security, medicare, medicaid, Federal employee retirement, unemployment compensation, food stamps and other means-tested entitlements. It also includes such programs as deposit insurance and farm price and income supports, where the Government is legally obligated to make payments under certain conditions. Receipts and direct spending are alike in that they involve ongoing activities that generally operate under permanent authority (they do not require annual authorization), and the underlying statutes generally specify the tax rates or benefit levels that must be collected or paid, and who must pay or who is eligible to receive benefits. The current services baseline assumes that receipts and direct spending programs continue in the future as specified by current law. In most cases, that is what will occur without enactment of new legislation. The budgetary impact of anticipated regulations and administrative actions that are permissible under current law are also reflected in the estimates.

If a baseline is intended to reflect current law, then the provisions of law providing spending authority and the authority to collect taxes or other receipts that expire under current law should be assumed to expire. However, the current services baseline assumes extension of several types of authority:

- Expiring provisions affecting excise taxes dedicated to a trust fund are assumed to be extended at current rates. During the projection period of 2004 through 2009, taxes deposited in the Leaking Underground Storage Tank trust fund, which are scheduled to expire on March 31, 2005, taxes deposited in the Highway and Aquatic Resources trust funds, which expire on September 30, 2005, and taxes deposited in the Airport and Airway trust fund, which expire on September 30, 2007, are the only taxes affected by this exception.
- Direct spending programs that will expire under current law are assumed to be extended if their 2004 outlays exceed $50 million. For example, Temporary Assistance for Needy Families and child care entitlement to States, which expired at the end of 2002 and have been temporarily extended several times, are now scheduled to expire in March, 2004. The baseline estimates provided here assume continuation of these programs throughout the projection period. However, programs enacted after the enactment of the Balanced Budget Act of 1997 that are explicitly temporary in nature expire in the baseline even if their current year outlays exceed the $50 million threshold.
- Certain provisions in the 2001 and 2003 Tax Acts that were clearly not intended to be temporary are assumed to continue past their expiration date. These provisions include tax rate reductions and marriage penalty tax relief. Unlike the two extensions discussed above, the BEA baseline definitions, developed before the enactment of the 2001 and 2003 tax acts, does not provide for extension of these provisions.

Discretionary spending.—Discretionary programs differ in one important aspect from direct spending programs—Congress usually provides spending authority for discretionary programs one year at a time. The spending authority is normally provided in the form of annual appropriations. Absent appropriations of additional funds in the future, discretionary programs would cease to exist after existing balances were spent. If the baseline was intended to reflect current law, then a baseline would only reflect the expenditure of remaining balances from appropriations laws. Instead the current services baseline provides a mechanical definition for discretionary programs that is somewhat arbitrary. The definition used here attempts to keep discretionary spending level in real terms. For 2004, the current services estimates for discretionary programs are based on enacted appropriations for the Departments of Defense and Homeland Security and the conference report on the Consolidated Appropriations Act for Fiscal Year 2004 for the remaining agencies. The estimates assume that the conference report will be adopted as reported. For 2005 through 2009, funding for most accounts is equal to this 2004 level adjusted for inflation. The inflation rates used here are similar to those required by the BEA but adjust to remove the overcompensation for federal pay inherent in the BEA definition. Unlike the BEA requirements, these current services estimates assume that federal pay raises are effective in January, as required under current law. At the time the BEA was enacted, it ignored the nearly contemporaneous enactment of the Federal Employees Compensation Act of 1991 that shifted the effective date of federal employee pay raises from October to January. In addition, the baseline estimates presented here assume that any emergency appropriation enacted for 2004 is a one-time only event. The BEA requires that the baseline assume funding for emergencies repeatedly through the projection period.

Alternative Formulations of Baseline

Throughout much of U.S. history, budget proposals were often compared to either the President's request or the previous year's budget. In the early 1970s, development of a baseline was pursued in attempt to provide a more neutral benchmark for comparisons. The Congressional Budget Act of 1974 included a requirement that OMB and the Congressional Budget Office (CBO) provide estimates of a current services baseline. The definition of the baseline was very general and specific guidance was not provided.

Since these estimates have been developed, current services for direct spending programs and receipts were generally estimated based on laws currently in place. Major direct spending programs were assumed to continue past their expiration date. The initial budget enforcement legislation, enacted in 1990, specifically required that programs sunset on schedule in the baseline. This provision was subsequently amended to require extension of most major direct spending programs. However, in the case of receipts, the BEA requires only the extension of trust fund excise taxes.

For discretionary programs, the proper definition of current services was more ambiguous. OMB, for most accounts, applied an inflation adjustment to the current year budgetary resource. However, numerous exceptions were made to give a better picture of providing the same services in the future. Programs that were clearly temporary in nature were allowed to expire. Some programs were allowed to grow along a path that reflected development of a project: design, followed by construction, followed by operating expenses. CBO also made similar adjustments to their estimates. In addition, they produced a baseline that straightlined budgetary resources rather than apply an inflation adjustment. With enactment of budget enforcement legislation in the 1990s, a precise definition of baseline for discretionary programs was instituted and all discretionary programs were estimated based on precise rules.

It is clear, however, that a number of "current services" definitions could be developed that differ for those presented in this chapter:

- *Extend provisions affecting parts of mandatory programs.* Currently, mandatory programs that have current year outlays of over $50 million are generally assumed to continue. However, provisions of law that affect parts of mandatory programs, even those that have been consistently extended in the past, are assumed to expire as scheduled. This creates an upward bias on spending as extensions of programs are not scored as increasing outlays where extension of savings provisions are counted as savings and provide offsets for other spending.
- *Do not extend any authorizing laws that expire.* If all mandatory programs were assumed to expire as scheduled, the deficit in 2005 would be $21 billion lower than the current estimates and deficits for 2005 through 2009 would be $208 billion lower. (See the section below on major program assumptions for details on mandatory program extensions assumed in the estimates.) If excise taxes were allowed to expire, the deficit would be $165 billion higher over the period 2005 through 2009. If certain provisions of the 2001 and 2003 Tax Acts were assumed to expire, the deficit would be $162 billion lower over the period.
- *Straightline appropriations.* If all discretionary budgetary resources were to be the same in each year in the projection period as provided for the current year, total outlays would be $13 lower in 2005 and $271 billion lower over the period 2005 through 2009.
- *Do not extend any appropriations.* The current treatment of expiring provisions is inconsistent with the treatment of discretionary spending. All discretionary spending continues whether there is authorization for the program or not and whether funds have already been provided or not. In nearly all cases, funds for discretionary programs have not been provided in advance for years beyond the current year. If rules consistent with the treatment of other expiring provisions were applied to discretionary spending, no new budgetary resources would be provided. Thus, the only discretionary outlays that would be included in the baseline would be the lagged spending from the current year budgetary resource. If this rule were followed, outlays in 2005 would be reduced by $570 billion relative to the current estimates. Clearly this would provide an unrealistic estimate of future spending and the government's future fiscal position.

Table 24–2. ALTERNATIVE BASELINE ASSUMPTIONS

(in billions of dollars)

	2004	2005	2006	2007	2008	2009	2005–2009
Current baseline deficit	–527	–360	–253	–229	–218	–211	–1,270
Alternative assumptions: [1]							
Extend provisions affecting parts of mandatory programs	–1	–*	*	*	*	1	2
Do not extend any authorizing laws:							
Mandatory spending [2]	8	21	22	24	66	76	208
Trust fund excise taxes	....	–*	–31	–33	–48	–52	–165
Certain provisions of the 2001 and 2003 Tax Acts	....	12	31	33	34	52	162
Straightline appropriations	....	13	30	50	75	102	271
Do not extend any appropriations	....	570	881	1,022	1,127	1,222	4,822

[1] A positive number represents a reduction in the deficit. All estimates include related debt service impacts.

[2] Estimates provided here are the totals for the illustrative provisions shown in Table 24–5. This is not a complete listing of all provisions that expire.

* $500 million or less.

Table 24–2 provides estimates for a variety of changes in baseline definitions that could be considered.

Economic Assumptions

The current services estimates are based on the same economic assumptions as the President's Budget, which are based on enactment of the President's Budget proposals. The economy and the budget interact. Changes in economic conditions significantly alter the estimates of tax receipts, unemployment benefits, entitlement payments that are automatically adjusted for changes in cost-of-living (COLAs), income support programs for low-income individuals, and interest on the Federal debt. In turn, Government tax and spending policies influence prices, economic growth, consumption, savings, and investment. Because of these interactions, it would be reasonable, from an economic perspective, to assume different economic paths for the current services baseline and the President's Budget. However, this would diminish the value of current services estimates as a benchmark for measuring proposed policy changes, because it would then be difficult to separate the effects of proposed policy changes from the effects of different economic assumptions. By using the same economic assumptions for current services and the President's Budget, this potential source of confusion is eliminated. The economic assumptions underlying both the budget and the current service estimates are summarized in Table 24–3. The economic outlook underlying these assumptions is discussed in greater detail in Chapter 2 of this volume.

Major Programmatic Assumptions

A number of programmatic assumptions must be made in order to calculate the baseline estimates. These include assumptions about the number of beneficiaries who will receive payments from the major benefit programs and annual cost-of-living adjustments in the indexed programs. Assumptions on baseline caseload projections for the major benefit programs are shown in Table 24–4. Assumptions about various automatic cost-of-living-adjustments are shown in Table 24–3.

Table 24–3. SUMMARY OF ECONOMIC ASSUMPTIONS

(Fiscal years; dollar amounts in billions)

	2003	2004	2005	2006	2007	2008	2009
Gross Domestic Product (GDP):							
Levels, dollar amounts in billions:							
Current dollars	10,828	11,466	12,042	12,641	13,279	13,973	14,702
Real, chained (2000) dollars	10,288	10,753	11,154	11,536	11,919	12,306	12,690
Percent change, year over year:							
Current dollars	4.4	5.9	5.0	5.0	5.0	5.2	5.2
Real, chained (2000) dollars	2.7	4.5	3.7	3.4	3.3	3.2	3.1
Inflation measures (percent change, year over year):							
GDP chained price index	1.6	1.3	1.3	1.5	1.7	1.9	2.0
Consumer price index (all urban)	2.4	1.6	1.4	1.7	2.0	2.3	2.5
Unemployment rate, civilian (percent)	6.0	5.7	5.5	5.3	5.2	5.1	5.1
Interest rates (percent):							
91-day Treasury bills	1.1	1.1	2.1	3.1	3.8	4.3	4.4
10-year Treasury notes	3.9	4.5	4.9	5.3	5.5	5.7	5.8
MEMORANDUM							
Related program assumptions:							
Automatic benefit increases (percent):							
Social security and veterans pensions	1.4	2.1	1.3	1.5	1.8	2.1	2.4
Federal employee retirement	1.4	2.1	1.3	1.5	1.8	2.1	2.4
Food stamps	2.9	1.3	2.1	1.5	1.7	2.1	2.3
Insured unemployment rate	2.8	2.7	2.5	2.4	2.3	2.3	2.3

Table 24–4. BENEFICIARY PROJECTIONS FOR MAJOR BENEFIT PROGRAMS

(Annual average, in thousands)

	2003 Actual	Estimate					
		2004	2005	2006	2007	2008	2009
Farmer direct payments	1,997	1,957	1,957	1,938	1,918	1,899	1,880
Federal family education loans	5,980	6,302	6,556	6,726	6,855	7,216	7,588
Federal direct student loans	2,073	2,163	2,275	2,382	2,507	2,635	2,768
Medicaid/State Children's Health Insurance Program	46,000	47,900	48,300	48,600	49,000	49,300	49,600
Medicare-eligible military retiree health benefits	1,634	1,682	1,720	1,754	1,788	1,827	1,863
Medicare:							
Hospital insurance	40,467	41,198	41,880	42,561	43,294	44,111	45,053
Supplementary medical insurance	38,369	38,928	39,477	40,028	40,619	41,282	42,054
Railroad retirement	629	614	599	585	573	562	553
Federal civil service retirement	2,383	2,386	2,407	2,441	2,473	2,505	2,538
Military retirement	2,006	2,030	2,052	2,074	2,099	2,118	2,132
Unemployment compensation	10,340	10,190	10,050	9,930	9,830	9,830	9,910
Food stamps	21,264	23,690	24,872	24,201	23,596	23,077	22,645
Child nutrition	31,194	31,929	32,427	32,941	33,448	33,966	34,494
Foster care and adoption assistance	558	584	609	638	668	700	733
Supplemental security income (SSI):							
Aged	1,150	1,134	1,122	1,113	1,107	1,104	1,102
Blind/disabled	5,403	5,577	5,745	5,877	5,975	6,049	6,116
Subtotal, SSI	6,553	6,711	6,867	6,990	7,082	7,153	7,218
Child care and development fund [1]	2,500	2,400	2,400	2,300	2,300	2,200	2,200
Social security (OASDI):							
Old age and survivor insurance	39,254	39,588	39,969	40,382	40,899	41,524	42,256
Disability insurance	7,330	7,664	7,996	8,302	8,587	8,855	9,082
Veterans compensation:							
Veterans	2,445	2,548	2,607	2,691	2,773	2,848	2,897
Survivors (non-veterans)	312	323	328	334	341	349	357
Subtotal, veterans compensation	2,757	2,871	2,935	3,025	3,114	3,197	3,254
Veterans pensions:							
Veterans	345	344	343	340	337	334	330
Survivors (non-veterans)	226	218	208	199	190	182	175
Subtotal, veterans pensions	571	562	551	539	527	516	505

[1] Includes children served through the CCDF (including TANF transfers) and through funds spent directly on child care in the Social Services Block Grant and TANF programs.

It is also necessary to make assumptions about the continuation of expiring programs and provisions. In the estimates provided here, expiring excise taxes dedicated to a trust fund are extended at current rates. Certain income tax provisions from the 2001 and 2003 Tax Acts, that were not designed to be temporary in nature, are assumed to be permanent for purposes of calculating revenue estimates. In general, mandatory programs with current year spending of at least $50 million are also assumed to continue. All discretionary programs with enacted appropriations in the current year are assumed to continue. However, specific provisions of law that affect mandatory programs (but are not necessary for program operation) are allowed to expire as scheduled. For example, medicaid transition assistance will expire mid-way through 2004. The baseline does not assume additional spending under this authority beyond that point. Table 24–5 provides a listing of mandatory programs and taxes assumed to continue in the baseline after their expiration.

Many other important assumptions must be made in order to calculate the baseline estimates. These include assumptions about the timing and substance of regulations that will be issued over the projection period, the use of administrative discretion provided under current law, and other assumptions about the way programs operate. Table 24–5 lists many of these assumptions and their impact on the baseline estimates. It is not intended to be an exhaustive listing; the variety and complexity of Government programs are too great to provide a complete list. Instead, some of the more important assumptions are shown.

Table 24–5. IMPACT OF REGULATIONS, EXPIRING AUTHORIZATIONS, AND OTHER ASSUMPTIONS IN THE BASELINE

(In millions of dollars)

Category	Estimate					
	2004	2005	2006	2007	2008	2009
REGULATIONS						
Foster care program:						
Administrative claims for children in unlicensed relative homes			–82	–87	–91	–96
Information and guidance on implemenation of AFCARS penalties			–2	–5	–5	–5
Old age and survivors insurance (OASI) and disabilty insurance (DI):						
Ticket to Work and Self-Sufficiency	6	18	26	27	18	5
Reduction of Title II benefits under family maximum in cases of dual entitlement	15	16	17	18	19	20
Trial work period	5	4	3	3	2	1
Musculoskeletal system and related criteria	–85	–110	–135	–165	–195	–225
Medicare, HI: [1]						
Inpatient Rehabiliation Facilities	–20	–50	–70	–70	–180	–230
Inpatient Psychiatric Facilities, Prospective Payment System						
Medicare, HI and SMI: [1]						
Consistent reimbursement for bad debt		–10	–40	–70	–80	–90
Supplemental security income (SSI):						
Ticket to Work and Self-Sufficiency	–5	–12	–12	–6	–3	–7
Title XVI cross-program recovery	–40	–30	–15	–15	–15	–15
Student earned income exclusion	3	4	4	4	4	5
Musculoskeletal system and related criteria	–15	–20	–25	–25	–30	–35
Interior:						
Bureau of Land Management cost recovery fees		–4	–4	–4	–4	–4
EXPIRING AUTHORIZATIONS						
Provisions extended in the baseline (effect of extension):						
Spending:						
Child care entitlement to States		2,717	2,717	2,717	2,717	2,717
Child nutrition:						
Summer food service program	308	329	352	374	398	420
State administrative expenses	149	156	162	167	175	181
CCC market access, bioenergy and commodity programs					5,412	10,300
Conservation reserve program						41
Farm security and rural investment:						
Conservation security program					873	1,046
Environmental quality incentives program					1,107	1,116
Farm and ranch lands protection program					134	136
Wildlife habitat incentives program					74	76
Wetlands reserve program					294	218
Food stamps:						
Benefit costs					25,994	26,312
State administrative expenses					2,553	2,626
Employment and training					321	326
Other program costs					70	71
Nutrition assistance for Puerto Rico					1,518	1,554
Food donations on Indian reservations					83	85
The emergency food assistance program commodities					140	140
Promoting safe and stable families				305	305	305
Temporary assistance for needy families (TANF) resources:						
State family assistance grants (SFAG)	6,595	16,489	16,489	16,489	16,489	16,489
SFAG to territories	31	78	78	78	78	78
Matching grants to territories	6	15	15	15	15	15
Bonus to reward high performing States	1000					
Bonus to reward decrease in illegitimacy	100	100	100	100	100	100
Tribal work program	8	8	8	8	8	8
Census survey of program dynamics	5	10	10	10	10	10
Trade adjustment assistance—training and income support					649	1,143
Trade adjustment assistance—farmers					90	90
Veterans compensation						
Annual cost-of-living adjustment		242	592	967	1,519	2,185
Revenues:						
Excise taxes dedicated to trust funds:						
Airport and Airway trust fund taxes					11,852	12,536
Aquatic resources trust fund taxes			328	338	349	359
Highway trust fund taxes			30,121	30,949	31,720	32,416
Leaking Underground Storage Tank taxes		82	202	208	211	217
Certain provisions for the 2001 tax cut and 2003 jobs and growth tax cut:						
Revenue effect		–11,776	–26,020	–26,321	–25,682	–41,828
Outlay effect			4,265	4,131	4,003	3,936

Table 24–5. IMPACT OF REGULATIONS, EXPIRING AUTHORIZATIONS, AND OTHER ASSUMPTIONS IN THE BASELINE—Continued

(In millions of dollars)

Category	Estimate					
	2004	2005	2006	2007	2008	2009
Provisions not extended in the baseline (effect of extension):						
Spending:						
Agriculture recreation fee demonstration project			–17	–12	–7	–2
Customs user fees		–820	–1,391	–1,448	–1,507	–1,570
EPA pesticides maintenance fee						–15
Medicare, SMI:						
Medicare low income premium assistance [2]		136	141	147	152	158
Medicaid:						
Transition benefits [3]	175	446	488	524	554	580
TANF:						
Supplemental grants	128	319	319	319	319	319
Welfare research	7	15	15	15	15	15
Veterans programs:						
Income verification match						–6
Authorize purchase of headstones				2	2	2
OTHER IMPORTANT PROGRAM ASSUMPTIONS						
Child support enforcement (CSE):						
Alternative penalties for Family Support Act systems and Statewide Disbursement Unit requirements	–166	–203	–188	175		
Effect of enhanced rate of paternity testing	8	8	8	8	8	8
Food stamps:						
Tax offset, recoupment, and general claims collection	–168	–177	–175	–175	–175	–177
Quality control liabilities			–18	–18	–16	–12
Allocation of administrative costs between public assistance programs	–197	–197	–197	–197	–197	–197
Medicare: [4]						
Medicare Advantage	38,460	49,435	62,558	82,744	92,250	102,607
Inpatient Hospital	118,552	125,786	124,173	122,175	125,593	130,527
Physicians	51,125	54,095	51,003	47,606	46,780	45,896
Medicaid:						
Financial management recoveries	–466	–482	–530	–580	–634	–691
Vaccines for Children, total program costs	1,208	1,208	1,201	984	1,009	1,028
Allocation of administrative costs between public assistance programs	432	471	509	549	593	640
Remaining upper payment limit-related costs	2,800	2,400	2,000	1,800	1,600	1,400
Institutional long term care	33,805	33,892	36,269	38,657	41,100	43,504
Home and community based institutional alternatives	18,457	19,002	22,015	25,539	29,705	34,515
Pharmaceuticals (FFS, net of rebates)	18,304	20,800	13,951	12,209	13,201	14,349
Managed care (including Medicaid MCOs, PHPs, PCCM)	29,809	31,853	36,188	40,589	45,032	49,368
State Children's Health Insurance Program (Title XXI)	5,232	5,299	5,292	5,494	5,566	5,601
Approved Demonstrations: [5]						
Medicare, HI:						
Mercy Medical SNF						
Baseline estimate	5	1				
Demonstration estimate	5	1				
Premier—Hospital Quality Incentive						
Baseline estimate	2,844	3,053	3,267	11		
Demonstration estimate	2,844	3,053	3,267	11		
Medicare, SMI:						
Municipal Health	15	17	19	5		
Baseline estimate	30	33	37	10		
Demonstration estimate						
Diabetes (Telemedicine)						
Baseline estimate	7	7	8	8		
Demonstration estimate	7	7	8	8		
United Mine Workers Program—Prescription Drug Benefits						
Baseline estimate						
Demonstration estimate	109	120				
Smoking Cessation						
Baseline estimate						
Demonstration estimate	*					
Home Health Third Party Liability						
Baseline estimate	153	110	85	62	59	
Demonstration estimate	153	110	85	62	59	
BIPA Disease Management						
Baseline estimate	101	271	288	144		
Demonstration estimate	101	270	286	142		
Case Management/Lovelace						
Baseline estimate	12	2				
Demonstration estimate	10	2				

Table 24–5. IMPACT OF REGULATIONS, EXPIRING AUTHORIZATIONS, AND OTHER ASSUMPTIONS IN THE BASELINE—Continued

(In millions of dollars)

Category	Estimate					
	2004	2005	2006	2007	2008	2009
Coordinated Care						
Baseline estimate	177	188	95			
Demonstration estimate	154	163	82			
Medicare: HI and SMI:						
Evercare						
Baseline estimate	206	69				
Demonstration estimate	206	69				
New York Graduate Medical Education						
Baseline estimate	53	53	53	53		
Demonstration estimate	45	37	26	13		
Medicare Lifestyle Modification Program						
Baseline estimate	1	1	1			
Demonstration estimate	1	1	1			
Medicare+Choice Phase I						
Baseline estimate	377	103				
Demonstration estimate	386	106				
Medicare+Choice Phase II						
Baseline estimate	859	945	260			
Demonstration estimate	916	1,008	277			
United Mine Workers Program—Health Benefits						
Baseline estimate	366	442				
Demonstration estimate	343	411				
UTAH GME						
Baseline estimate	5	5	6	6		
Demonstration estimate	5	5	6	6		
SHMO-ESRD						
Baseline estimate	16	16	4			
Demonstration estimate	18	18	5			
NJHA Hospital Performance Based Incentive						
Baseline estimate	260	372	400	107		
Demonstration estimate	255	365	392	105		
S/HMOs—Medicare						
Baseline estimate	893	295				
Demonstration estimate	1,050	347				
S/HMO II—Medicare						
Baseline estimate	533	172				
Demonstration estimate	550	182				
Virginia Cardiac Surgery Initiative						
Baseline estimate	28	115	118	90		
Demonstration estimate	28	114	116	89		
Medicaid: [5]						
Alabama Family Planning	239	202				
Arizona AHCCCS	2,515	2,733	3,029			
Arkansas (ARKids B)	49	44				
Arkansas Family Planning Services	169	207	35			
Arkansas Cash & Counseling	8	8	8	7		
Arkansas TEFRA	38	46	57	69		
California Family Planning	159	27				
California—LA County [6]	123	65				
Colorado Consumer Directed Attendent Support	4	5	5	6	1	
Delaware—Diamond State Health Plan	409	456	504	129		
District of Columbia HIV	2	10	12	15		
District of Columbia Childless Adults 50–64	5	5	5	3		
Florida Family Planning	10	8	8	1		
Florida Cash & Counseling	49	53	57	62	26	
Hawaii Health QUEST	284	143				
Kentucky Health Care Partnership Program	324	335	28			
Maine HIV	7	8	9	7		
Maryland (Health Choice)	1,282	975				
Massachusetts MassHealth	2,428	1,866				
Minnesota (Prepaid Med. Assist. Project Plus)	117	104				
Mississippi Family Planning	105	115	125	137	109	
Missouri Managed Care Plus	204	205	204	86		
New Jersey Cash & Counseling	4	2				
New Mexico—Family Planning Expansion	8	9	11			
New York (Partnership Plan)	9,421	9,753	5,252			
Oklahoma Sooner Care	168	843	906	230		

Table 24–5. IMPACT OF REGULATIONS, EXPIRING AUTHORIZATIONS, AND OTHER ASSUMPTIONS IN THE BASELINE—Continued

(In millions of dollars)

Category	Estimate					
	2004	2005	2006	2007	2008	2009
Oregon Family Planning	58	65	76	6		
Oregon Independent Choices	2	2	3	*		
Rhode Island Rite Care (Medicaid)	126	103				
South Carolina Family Planning	19	7				
TennCare II	3,244	3,488	3,865	3,124		
Utah (Primary Care Network)	81	87	97	79		
Vermont Health Access Plan	344	208	214	54		
Virginia—Family Planning	159	165	171	176		
Washington (Take Charge/Family Planning)	179	200	160			
Wisconsin Badger Care (Medicaid)	19					
Wisconsin Family Planning	23	28	34	40	10	
Pharmacy plus (demonstration estimate):						
Wisconsin Pharmacy Plus	154	183	218	260		
Florida Pharmacy Plus	87	95	105	93		
Illinois Pharmacy Plus	232	298	357	277		
South Carolina Pharmacy Plus	129	153	179	208	52	
State Children's Health Insurance Program (Title XXI) (demonstration estimates): [5]						
Maryland Health Choice [7]	126	90				
Minnesota Care	64	47				
Missouri MC+ [7]	82	91	103	117		
New Jersey FamilyCare	19					
New Mexico SCHIP [7]	20	23				
Rhode Island (SCHIP RiteCare)	10	10				
Wisconsin (BadgerCare)	33					
Health Insurance Flexibility and Accountability (HIFA) (demonstration estimate):						
Arizona HIFA amendment to AHCCCS (SCHIP funds)	39	41	43			
California HIFA (SCHIP funds)	466	487	337			
Colorado HIFA Adult Prenatal Coverage (SCHIP funds)	13	14				
Illinois HIFA (KidCare Parent Coverage)						
Demonstration estimate (SCHIP funds)	33	72	106	150		
Baseline estimate (Medicaid funds)	71	85	113	148		
Maine HIFA (Maine Care for Childless Adults—Medicaid funds)						
Baseline estimate	61	57	57	57		
New Mexico HIFA (SCHIP funds)	13	15	19	22		
Oregon HIFA (Oregon Health Plan 2)						
Demonstration estimate (SCHIP funds)	30	33	36	6		
Baseline estimate (Medicaid funds)	1,457	1,558	1,718	1,893	159	
Joint Medicare and Medicaid:						
Minnesota-Dual Eligibles						
Demonstration estimate	88					
Baseline estimate	92					
Wisconsin-Dual Eligibles						
Demonstration estimate	97	127	167			
Baseline estimate	97	127	167			
Massachusetts—Dual Eligibles						
Demonstration estimate	11	21	29	35		
Baseline estimate	15	28	38	50		
OASI, DI, SSI:						
Performance of continuing disability reviews (baseline levels) (OASI, DI, SSI)	–90	–570	–1,150	–1,700	–2,385	–2,990
Collection of overpayments:						
OASI	–640	–650	–650	–650	–650	–650
DI	–460	–498	–498	–498	–498	–498
SSI (federal)	–849	–903	–903	–903	–903	–903
Debts written off as uncollectable (no effect on outlays):						
OASI	108	110	110	110	110	110
DI	363	393	393	393	393	393
SSI (federal)	511	544	544	544	544	544
OASDI:						
Payments to states for vocational rehabilitation	93	100	109	116	124	132
Research and demonstration projects	14	51	74	37		
SSI:						
Payments from states for state supplemental benefits	–4,229	–4,314	–4,485	–4,661	–4,762	–4,925
Payments for state supplemental benefits	4,195	4,670	4,485	4,270	4,755	4,910
Fees for administration of State supplement:						
Treasury share	–153	–156	–159	–161	–163	–164
SSA share	–120	–121	–128	–135	–142	–151
Research and demonstration projects	51	42	28	28	28	29

Table 24–5. IMPACT OF REGULATIONS, EXPIRING AUTHORIZATIONS, AND OTHER ASSUMPTIONS IN THE BASELINE

(In millions of dollars)

Category	Estimate					
	2004	2005	2006	2007	2008	2009
Payments to states for vocational rehabilitation	89	92	98	106	111	117
Performance of non-disability redeterminations (excludes related overpayment collections reported above)	–980	–1,800	–1,985	–2,145	–2,290	–2,430
Ticket to work grant programs:						
Infrastructure grant program	15	22	26	27	30	31
Demonstration to maintain independence and employment	1	6	7	8	10	10

* = $500,000 or less.

NA = Not available.

[1] Medicare regulations reflect gross outlays.

[2] Current law extends program through September 30, 2004.

[3] Current law extends program to March 31, 2004.

[4] Not shown on table are anticipated collections from various state liabilities under current law.

[5] Baseline estimates reflect costs absent the demonstration; demonstration estimate reflects costs of the demonstration.

[6] Budget modified from original agreement for phase-out of waiver funding.

[7] Estimates reflect costs for SCHIP children under the State's Medicaid 1115.

Current Services Receipts, Outlays, and Budget Authority

Receipts.—Table 24–6 shows baseline receipts by major source. Total receipts are projected to increase by $245 billion from 2004 to 2005 and by $599 billion from 2005 to 2009, largely due to assumed increases in incomes resulting from both real economic growth and inflation.

Individual income taxes are estimated to increase by $116 billion from 2004 to 2005 under current law. This growth of 15.2 percent is primarily the effect of increased collections resulting from rising personal incomes and the timing and magnitude of tax changes provided under the 2001 and 2003 tax cuts. Individual income taxes are projected to grow at an annual rate of 8.5 percent between 2005 and 2009.

Corporation income taxes under current law are estimated to grow by $60 billion or 37.1 percent between 2004 and 2005, in large part due to increasing corporate profits and the timing and magnitude of tax changes provided in the 2002 economic stimulus bill and the 2001 and 2003 tax cuts. Corporation income taxes are projected to increase at an annual rate of 4.5 percent from 2005 to 2009, reflecting higher corporate profits.

Social insurance and retirement receipts are estimated to increase by $62 billion between 2004 and 2005, and by an additional $166 billion between 2005 and 2009. The estimates reflect assumed increases in total wages and salaries paid, and scheduled increases in the social security taxable earnings base from $87,900 in 2004 to $106,200 in 2009.

Excise taxes are estimated to increase by $11 billion from 2004 to 2009, in large part due to increased economic activity. Other baseline receipts (estate and gift taxes, customs duties, and miscellaneous receipts) are projected to increase by $28 billion from 2004 to 2009.

The current services revenue estimates reflect a downward adjustment for revenue uncertainty of $20 billion in 2004 and $15 billion in 2005. These amounts reflect an additional adjustment to receipts beyond what the economic and tax models forecast that has been made in the interest of cautious and prudent forecasting.

Outlays.—Current services outlays are estimated to grow from $2,319 billion in 2004 to $2,397 billion in 2005, a 3.4 percent increase. Between 2004 and 2009,

Table 24–6. BASELINE RECEIPTS BY SOURCE

(In billions of dollars)

	2003	Estimate					
		2004	2005	2006	2007	2008	2009
Individual income taxes	793.7	765.8	882.0	969.4	1,051.5	1,139.6	1,220.1
Corporation income taxes	131.8	162.1	222.1	246.8	252.2	258.1	264.9
Social insurance and retirement receipts	713.0	732.4	794.0	834.0	878.6	918.6	960.0
On-budget	189.1	198.4	218.9	230.9	242.3	251.0	261.1
Off-budget	523.8	534.0	575.1	603.1	636.3	667.6	698.9
Excise taxes	67.5	70.2	73.2	74.8	76.9	79.1	81.3
Other	76.4	80.8	80.3	89.9	94.5	101.7	109.3
Adjustment for revenue uncertainty	....	–20.0	–15.0	....	....	....	....
Total	1,782.3	1,791.2	2,036.6	2,214.9	2,353.7	2,497.1	2,635.6
On-budget	1,258.5	1,257.2	1,461.5	1,611.7	1,717.4	1,829.5	1,936.7
Off-budget	523.8	534.0	575.1	603.1	636.3	667.6	698.9

they are projected to increase at an average annual rate of 4.2 percent. Outlays for discretionary programs remain almost level from 2004 to 2005, largely reflecting increases in resources to keep pace with inflation offset by a reduction from lower spending for the war. Discretionary outlays actually decline from 2005 to 2006, largely from continued fall off in war spending. Reflecting increases in resources to keep pace with inflation, outlays rise each year thereafter, reaching $933 billion in 2009. Entitlement and other mandatory programs are estimated to grow from $1,254 billion in 2004 to $1,309 billion in 2005, and to $1,618 billion in 2009, due in large part to changes in the number of beneficiaries and to automatic cost-of-living adjustments and other adjustments for inflation. Social security outlays grow from $492 billion in 2004 to $608 billion in 2009, an average annual rate of 4.3 percent. Medicare and medicaid are projected to grow at annual average rates of 9.4 and 6.9 percent, respectively, outpacing inflation. Offsetting growth in other areas, unemployment compensation declines from $46 billion in 2004 to $40 billion in 2005, reflecting lower unemployment rates as economic growth increases. Other areas of growth are federal employee retirement and other income security programs, including food assistance, the earned income and child tax credits, and the supplemental security income program.

Net interest payments to the public total $156 billion in 2004 and $178 billion in 2005. They rise each year reaching $296 billion in 2009. This pattern reflects increased borrowing requirements as well as changes in the mix of debt issuance and interest rates over the period.

Tables 24–8 and 24–9 show current services outlays by function and by agency, respectively. A more detailed presentation of outlays (by function, subfunction, category, and program) appears on the CD-ROM that accompanies this volume.

Budget authority.—Tables 24–10 and 24–11 show current services estimates of budget authority by function and by agency, respectively. A more detailed presentation of budget authority with program level estimates appears on the CD–ROM that accompanies this volume.

Table 24–7. CHANGE IN BASELINE OUTLAY ESTIMATES BY CATEGORY

(Dollar amounts In billions)

	2004	2005	2009	Change 2004 to 2005		Change 2004 to 2009	
				Amount	Percent	Amount	Average Annual Rate
Outlays:							
Discretionary:							
Defense	451.6	438.8	442.8	–12.8	–2.8%	–8.8	–0.4%
Nondefense	456.6	470.8	489.7	14.2	3.1%	33.1	1.4%
Subtotal, discretionary	908.2	909.6	932.5	1.4	0.2%	24.3	0.5%
Mandatory:							
Medicaid	177.1	183.2	246.9	6.1	3.4%	69.8	6.9%
Medicare	265.9	289.6	417.7	23.7	8.9%	151.7	9.4%
Federal employee retirement and disability	89.1	92.7	107.5	3.6	4.0%	18.4	3.8%
Unemployment compensation	45.6	40.5	45.4	–5.1	–11.2%	–0.2	–0.1%
Other income security programs	151.4	161.5	171.2	10.1	6.7%	19.8	2.5%
Social Security	492.0	510.5	608.1	18.5	3.8%	116.2	4.3%
Other mandatory programs	92.4	93.3	95.8	0.9	0.9%	3.4	0.7%
Undistributed offsetting receipts	–59.3	–62.2	–75.0	–2.8	4.8%	–15.6	4.8%
Subtotal, mandatory	1,254.2	1,309.1	1,617.6	54.9	4.4%	363.4	5.2%
Net interest	156.3	178.0	296.4	21.7	13.9%	140.1	13.7%
Total outlays	2,318.7	2,396.7	2,846.6	78.0	3.4%	527.8	4.2%

Table 24–8. CURRENT SERVICES OUTLAYS BY FUNCTION

(in billions of dollars)

Function	2003 Actual	Estimate					
		2004	2005	2006	2007	2008	2009
National defense:							
Department of Defense—Military	387.3	434.8	420.6	399.1	402.6	414.6	424.1
Other	17.6	18.9	19.7	19.7	19.7	19.9	20.3
Total, National defense	404.9	453.7	440.3	418.8	422.3	434.5	444.3
International affairs	21.2	34.2	36.6	29.3	26.8	27.0	27.5
General science, space, and technology	20.9	22.3	23.8	23.7	24.5	25.0	25.4
Energy	–0.8	1.0	1.2	1.6	1.6	1.7	1.8
Natural resources and environment	29.7	31.7	32.5	33.6	35.3	36.2	37.0
Agriculture	22.6	20.1	22.4	21.3	21.2	21.0	21.2
Commerce and housing credit	–1.6	7.7	3.8	–1.2	–0.4	–0.7	0.1
On-Budget	(3.6)	(12.7)	(4.1)	(2.8)	(3.6)	(4.0)	(4.3)
Off-Budget	(–5.2)	(–5.0)	(–0.2)	(–4.0)	(–3.9)	(–4.7)	(–4.3)
Transportation	67.1	68.2	69.5	70.1	71.1	72.5	74.5
Community and regional development	18.8	18.8	17.3	16.2	16.7	15.8	15.7
Education, training, employment, and social services	82.6	87.2	89.5	89.4	90.2	91.4	93.2
Health	219.6	243.3	254.2	266.0	283.6	304.6	326.6
Medicare	249.4	270.5	295.2	342.1	378.0	399.6	424.1
Income security	334.4	339.5	348.8	353.6	357.4	366.5	373.8
Social security	474.7	496.2	514.8	533.5	556.6	581.3	613.0
On-Budget	(13.3)	(14.3)	(15.1)	(16.4)	(17.9)	(20.5)	(21.5)
Off-Budget	(461.4)	(481.9)	(499.7)	(517.1)	(538.6)	(560.8)	(591.5)
Veterans benefits and services	57.0	60.5	68.3	69.1	69.4	75.8	79.6
Administration of justice	35.4	41.6	42.7	43.5	43.2	44.5	46.8
General government	23.0	25.4	19.9	20.1	20.9	21.8	22.3
Net interest	153.1	156.3	178.0	213.2	245.5	273.1	296.4
On-Budget	(236.6)	(242.6)	(269.9)	(313.3)	(355.6)	(395.5)	(433.1)
Off-Budget	(–83.5)	(–86.3)	(–91.9)	(–100.1)	(–110.2)	(–122.4)	(–136.6)
Allowances	....	....	....	–1.2	–1.2	....	....
Undistributed offsetting receipts:							
Employer share, employee retirement (on-budget)	–39.8	–44.1	–46.1	–48.3	–50.9	–53.6	–56.5
Employer share, employee retirement (off-budget)	–9.6	–10.7	–11.2	–11.8	–12.5	–13.5	–14.4
Rents and royalties on the Outer Continental Shelf	–5.0	–4.6	–4.8	–5.6	–5.6	–5.7	–5.7
Sale of major assets	....	....	....	–0.3	....	....	....
Other undistributed offsetting receipts	....	....	–0.1	–9.0	–11.2	–4.2	–*
Total, Undistributed offsetting receipts	–54.4	–59.3	–62.2	–75.0	–80.2	–77.0	–76.6
On-Budget	(–44.8)	(–48.7)	(–51.0)	(–63.2)	(–67.7)	(–63.5)	(–62.2)
Off-Budget	(–9.6)	(–10.7)	(–11.2)	(–11.8)	(–12.5)	(–13.5)	(–14.4)
Total	**2,157.6**	**2,318.7**	**2,396.7**	**2,467.7**	**2,582.5**	**2,714.7**	**2,846.6**
On-Budget	(1,794.6)	(1,938.7)	(2,000.4)	(2,066.5)	(2,170.5)	(2,294.4)	(2,410.4)
Off-Budget	(363.0)	(380.0)	(396.3)	(401.2)	(412.0)	(420.2)	(436.2)

* $50 million or less.

Table 24–9. CURRENT SERVICES OUTLAYS BY AGENCY

(in billions of dollars)

Agency	2003 Actual	Estimate					
		2004	2005	2006	2007	2008	2009
Legislative Branch	3.4	4.3	4.2	4.1	4.3	4.4	4.5
Judicial Branch	5.1	5.3	5.6	5.7	5.9	6.1	6.3
Agriculture	72.4	77.7	82.8	82.4	83.4	84.6	86.3
Commerce	5.7	6.2	6.2	6.3	6.4	6.6	6.8
Defense—Military	388.9	435.7	420.8	399.1	402.6	414.6	424.1
Education	57.4	62.8	64.4	64.2	64.7	65.4	66.6
Energy	19.4	20.6	21.8	21.9	21.9	22.2	22.6
Health and Human Services	505.3	547.7	581.9	639.8	692.8	734.4	780.5
Homeland Security	32.0	30.7	30.8	30.8	31.6	31.7	31.9
Housing and Urban Development	37.5	46.2	39.6	39.4	40.4	36.9	33.9
Interior	9.2	10.0	9.8	10.6	11.3	11.5	11.7
Justice	21.5	23.5	23.4	23.5	22.6	23.3	24.9
Labor	69.6	59.9	54.9	55.0	56.0	58.2	61.0
State	9.3	11.3	10.7	10.3	10.6	10.7	11.0
Transportation	50.8	58.0	59.2	59.8	60.4	61.6	63.2
Treasury	367.0	369.0	399.3	448.4	495.5	541.0	585.6
Veterans Affairs	56.9	60.4	68.2	68.9	69.2	75.6	79.4
Corps of Engineers—Civil Works	4.8	4.3	4.7	4.9	5.0	5.1	5.3
Other Defense Civil Programs	39.9	40.3	40.5	40.8	41.2	41.6	41.8
Environmental Protection Agency	8.1	8.1	8.4	8.4	8.8	9.0	9.0
Executive Office of the President	0.4	6.6	9.9	4.2	1.1	0.6	0.4
General Services Administration	0.6	0.8	0.7	0.3	0.4	0.4	0.4
International Assistance Programs	13.5	17.4	15.8	15.0	15.4	16.0	16.3
National Aeronautics and Space Administration	14.6	14.6	15.9	15.6	16.3	16.6	16.9
National Science Foundation	4.7	5.3	5.5	5.6	5.7	5.9	6.0
Office of Personnel Management	54.1	57.6	60.6	63.7	65.8	69.2	72.5
Small Business Administration	1.6	4.0	0.7	0.8	0.8	0.8	0.9
Social Security Administration	507.7	530.5	553.4	570.7	592.3	622.2	655.3
On-Budget	(46.3)	(48.6)	(53.7)	(53.6)	(53.6)	(61.4)	(63.8)
Off-Budget	(461.4)	(481.9)	(499.7)	(517.1)	(538.6)	(560.8)	(591.5)
Other Independent Agencies	6.9	11.4	18.6	13.6	14.6	14.6	15.3
On-Budget	(12.2)	(16.4)	(18.8)	(17.6)	(18.6)	(19.2)	(19.6)
Off-Budget	(–5.2)	(–5.0)	(–0.2)	(–4.0)	(–3.9)	(–4.7)	(–4.3)
Allowances	....	....	....	–1.2	–1.2	....	....
Undistributed Offsetting Receipts	–210.4	–211.4	–221.5	–245.0	–263.3	–275.8	–293.7
On-Budget	(–117.3)	(–114.5)	(–118.3)	(–133.2)	(–140.6)	(–140.0)	(–142.7)
Off-Budget	(–93.1)	(–96.9)	(–103.1)	(–111.9)	(–122.7)	(–135.9)	(–151.0)
Total	**2,157.6**	**2,318.7**	**2,396.7**	**2,467.7**	**2,582.5**	**2,714.7**	**2,846.6**
On-Budget	(1,794.6)	(1,938.7)	(2,000.4)	(2,066.5)	(2,170.5)	(2,294.4)	(2,410.4)
Off-Budget	(363.0)	(380.0)	(396.3)	(401.2)	(412.0)	(420.2)	(436.2)

Table 24–10. CURRENT SERVICES BUDGET AUTHORITY BY FUNCTION

(in billions of dollars)

Function	2003 Actual	Estimate					
		2004	2005	2006	2007	2008	2009
National defense:							
Department of Defense—Military	437.9	441.7	390.0	399.4	409.5	420.4	431.9
Other	18.3	18.8	19.0	19.3	19.6	20.0	20.4
Total, National defense	456.2	460.5	409.0	418.7	429.1	440.4	452.4
International affairs	31.7	41.3	25.2	26.9	27.7	28.5	29.3
General science, space, and technology	23.1	23.4	23.7	24.2	24.6	25.2	25.7
Energy	0.5	1.2	1.2	1.9	1.7	1.9	2.2
Natural resources and environment	31.8	32.2	33.5	33.9	35.3	36.2	37.7
Agriculture	24.7	19.5	22.7	21.8	21.7	21.4	21.4
Commerce and housing credit	14.9	14.0	9.0	8.6	10.8	11.0	10.8
On-Budget	(9.5)	(11.8)	(9.3)	(8.1)	(9.7)	(10.1)	(10.3)
Off-Budget	(5.4)	(2.2)	(–0.3)	(0.4)	(1.0)	(1.0)	(0.4)
Transportation	68.7	69.4	70.1	70.9	71.6	72.2	72.9
Community and regional development	16.7	16.3	15.4	15.7	16.0	16.3	16.6
Education, training, employment, and social services	87.6	87.9	90.8	91.4	92.0	93.4	95.2
Health	231.7	251.1	250.6	265.7	284.2	305.3	329.7
Medicare	249.9	271.0	295.1	342.5	377.7	399.6	424.5
Income security	329.5	336.4	342.2	349.1	353.7	366.4	380.8
Social security	476.6	497.8	516.2	535.1	558.6	583.5	615.9
On-Budget	(13.3)	(14.3)	(15.1)	(16.4)	(17.9)	(20.5)	(21.5)
Off-Budget	(463.3)	(483.5)	(501.1)	(518.7)	(540.7)	(563.0)	(594.4)
Veterans benefits and services	59.1	60.4	66.0	69.6	72.9	76.5	80.4
Administration of justice	39.7	42.7	42.0	42.2	43.6	44.9	47.2
General government	25.0	23.9	20.4	21.0	21.6	22.3	23.0
Net interest	153.2	156.2	178.0	213.2	245.5	273.1	296.4
On-Budget	(236.7)	(242.5)	(269.9)	(313.3)	(355.6)	(395.5)	(433.1)
Off-Budget	(–83.5)	(–86.3)	(–91.9)	(–100.1)	(–110.2)	(–122.4)	(–136.6)
Allowances	....	....	....	–1.2	–1.2	....	....
Undistributed offsetting receipts:							
Employer share, employee retirement (on-budget)	–39.8	–44.1	–46.1	–48.3	–50.9	–53.6	–56.5
Employer share, employee retirement (off-budget)	–9.6	–10.7	–11.2	–11.8	–12.5	–13.5	–14.4
Rents and royalties on the Outer Continental Shelf	–5.0	–4.6	–4.8	–5.6	–5.6	–5.7	–5.7
Sale of major assets	....	....	....	–0.3	....	....	....
Other undistributed offsetting receipts	....	....	–0.1	–9.0	–11.2	–4.2	–*
Total, Undistributed offsetting receipts	–54.4	–59.3	–62.2	–75.0	–80.2	–77.0	–76.6
On-Budget	(–44.8)	(–48.7)	(–51.0)	(–63.2)	(–67.7)	(–63.5)	(–62.2)
Off-Budget	(–9.6)	(–10.7)	(–11.2)	(–11.8)	(–12.5)	(–13.5)	(–14.4)
Total	**2,266.2**	**2,346.1**	**2,349.0**	**2,476.2**	**2,606.8**	**2,741.2**	**2,885.5**
On-Budget	(1,890.6)	(1,957.3)	(1,951.2)	(2,068.9)	(2,187.7)	(2,313.1)	(2,441.6)
Off-Budget	(375.5)	(388.8)	(397.7)	(407.3)	(419.0)	(428.1)	(443.8)
MEMORANDUM							
Discretionary budget authority:							
National defense	455.0	458.6	407.5	417.2	427.6	438.8	450.7
International	33.5	48.6	27.3	27.8	28.3	28.9	29.6
Domestic	361.0	367.5	376.9	385.9	396.1	406.3	418.3
Total	**849.4**	**874.7**	**811.7**	**830.8**	**851.9**	**874.0**	**898.6**

* $50 million or less.

Table 24–11. CURRENT SERVICES BUDGET AUTHORITY BY AGENCY

(in billions of dollars)

Agency	2003 Actual	Estimate					
		2004	2005	2006	2007	2008	2009
Legislative Branch	3.9	3.9	4.1	4.2	4.3	4.5	4.6
Judicial Branch	5.2	5.5	5.7	5.8	6.0	6.2	6.4
Agriculture	78.4	78.4	85.4	85.6	86.9	88.0	89.9
Commerce	5.8	5.9	6.2	6.3	6.5	6.7	6.9
Defense—Military	439.5	442.7	390.0	399.4	409.5	420.4	431.9
Education	63.3	63.3	65.7	65.8	66.0	67.0	68.3
Energy	20.6	21.0	21.3	21.5	21.9	22.4	22.8
Health and Human Services	515.9	556.4	573.9	638.6	692.4	734.7	784.3
Homeland Security	30.8	28.8	31.4	30.1	30.8	31.6	34.6
Housing and Urban Development	34.4	34.7	35.0	35.1	35.9	36.6	37.4
Interior	10.4	10.4	10.7	10.5	10.9	11.3	11.8
Justice	23.7	24.9	23.0	22.1	22.8	23.5	25.2
Labor	69.1	60.0	54.7	55.0	56.1	57.9	60.4
State	10.3	10.6	10.1	10.3	10.6	10.8	11.1
Transportation	54.4	59.4	59.8	60.3	60.8	61.1	61.5
Treasury	367.9	369.6	400.7	449.7	496.7	542.0	586.7
Veterans Affairs	58.9	60.3	65.8	69.5	72.7	76.3	80.1
Corps of Engineers—Civil Works	4.8	4.6	4.7	4.9	5.0	5.2	5.3
Other Defense Civil Programs	40.0	40.0	40.5	40.8	41.2	41.6	41.8
Environmental Protection Agency	7.9	8.4	8.4	8.6	8.8	9.0	9.3
Executive Office of the President	2.6	18.8	0.3	0.4	0.4	0.4	0.4
General Services Administration	1.3	0.4	0.5	0.5	0.5	0.5	0.5
International Assistance Programs	18.5	13.4	14.8	16.3	16.7	17.1	17.5
National Aeronautics and Space Administration	15.4	15.4	15.6	15.9	16.3	16.6	17.0
National Science Foundation	5.4	5.6	5.7	5.8	5.9	6.0	6.1
Office of Personnel Management	57.3	60.6	63.4	66.5	69.0	72.2	75.7
Small Business Administration	1.6	4.1	0.8	0.8	0.8	0.9	0.9
Social Security Administration	509.4	532.0	554.1	572.3	594.7	624.4	658.2
On-Budget	(46.2)	(48.5)	(53.0)	(53.6)	(54.0)	(61.4)	(63.8)
Off-Budget	(463.3)	(483.5)	(501.1)	(518.7)	(540.7)	(563.0)	(594.4)
Other Independent Agencies	19.8	18.4	18.2	19.8	21.3	22.1	22.3
On-Budget	(14.5)	(16.2)	(18.4)	(19.4)	(20.3)	(21.2)	(21.9)
Off-Budget	(5.4)	(2.2)	(–0.3)	(0.4)	(1.0)	(1.0)	(0.4)
Allowances	....	....	....	–1.2	–1.2	....	....
Undistributed Offsetting Receipts	–210.4	–211.4	–221.5	–245.0	–263.3	–275.8	–293.7
On-Budget	(–117.3)	(–114.5)	(–118.3)	(–133.2)	(–140.6)	(–140.0)	(–142.7)
Off-Budget	(–93.1)	(–96.9)	(–103.1)	(–111.9)	(–122.7)	(–135.9)	(–151.0)
Total	**2,266.2**	**2,346.1**	**2,349.0**	**2,476.2**	**2,606.8**	**2,741.2**	**2,885.5**
On-Budget	(1,890.6)	(1,957.3)	(1,951.2)	(2,068.9)	(2,187.7)	(2,313.1)	(2,441.6)
Off-Budget	(375.5)	(388.8)	(397.7)	(407.3)	(419.0)	(428.1)	(443.8)

THE BUDGET SYSTEM AND CONCEPTS

25. THE BUDGET SYSTEM AND CONCEPTS

The budget system of the United States Government provides the means for the President and Congress to decide how much money to spend, what to spend it on, and how to raise the money they have decided to spend. Through the budget system, they determine the allocation of resources among the agencies of the Federal Government. The budget system focuses primarily on dollars, but it also allocates other resources, such as Federal employment. The decisions made in the budget process affect the nation as a whole, State and local governments, and individual Americans. Many budget decisions have worldwide significance. The Congress and the President enact budget decisions into law. The budget system ensures that these laws are carried out.

This chapter provides an overview of the budget system and explains some of the more important budget concepts. It includes summary dollar amounts to illustrate major concepts. Other chapters of the budget documents discuss these amounts and more detailed amounts in greater depth.

The following section discusses the budget process, covering formulation of the President's budget, Congressional action, and budget execution. The next section provides information on budget coverage, including a discussion of on-budget and off-budget amounts, functional classification, how budget data is arrayed, types of funds, and full cost budgeting. Subsequent sections discuss the concepts of collections, budget authority, and outlays. These sections are followed by discussions of Federal credit; surpluses, deficits, and means of financing; Federal employment; and the basis for the budget figures. A glossary of budget terms appears at the end of the chapter.

Various laws, enacted to carry out requirements of the Constitution, govern the budget system. The chapter refers to the principal ones by title throughout the text and gives complete citations in the section just preceding the glossary.

THE BUDGET PROCESS

The budget process has three main phases, each of which is interrelated with the others:

(1) Formulation of the President's proposed budget;
(2) Congressional action on the budget; and
(3) Budget execution.

Formulation of the President's Budget

The Budget of the United States Government consists of several volumes that set forth the President's financial proposal with recommended priorities for the allocation of resources by the Government. The primary focus of the budget is on the budget year—the next fiscal year for which Congress needs to make appropriations, in this case 2005. (Fiscal year 2005 will begin on October 1, 2004 and end on September 30, 2005.) The budget also covers at least the four years following the budget year in order to reflect the effect of budget decisions over the longer term. It includes the funding levels provided for the current year, in this case 2004, so that the reader can compare the President's budget proposals to the most recently enacted levels, and it includes data on the most recently completed fiscal year, in this case 2003, so that the reader can compare budget estimates to actual accounting data.

The President begins the process of formulating the budget by establishing general budget and fiscal policy guidelines, usually by the Spring of each year, at least nine months before the President transmits the budget to Congress and at least 18 months before the fiscal year begins. (See the "Budget Calendar" below.) Based on these guidelines, the Office of Management and Budget (OMB) works with the Federal agencies to establish specific policy directions and planning levels for the agencies, both for the budget year and for at least the following four years, to guide the preparation of their budget requests.

During the formulation of the budget, the President, the Director of OMB, and other officials in the Executive Office of the President continually exchange information, proposals, and evaluations bearing on policy decisions with the Secretaries of the departments and the heads of the other Government agencies. Decisions reflected in previously enacted budgets, including the one for the fiscal year in progress, reactions to the last proposed budget (which Congress is considering when the process of preparing the upcoming budget begins), and how programs are actually performing influence decisions concerning the upcoming budget. So do projections of the economic outlook, prepared jointly by the Council of Economic Advisers, OMB, and the Treasury Department.

In early Fall, agencies submit their budget requests to OMB, where analysts review them and identify issues that OMB officials need to discuss with the agencies. OMB and the agencies resolve many issues themselves. Others require the involvement of the President and White House policy officials. This decision-making process is usually completed by late December. At that time, the final stage of developing detailed budget data and the preparation of the budget documents begins.

The decision-makers must consider the effects of economic and technical assumptions on the budget estimates. Interest rates, economic growth, the rate of inflation, the unemployment rate, and the number of people eligible for various benefit programs, among other things, affect Government spending and receipts. Small changes in these assumptions can affect budget estimates by billions of dollars. (Chapter 11, "Economic Assumptions," provides more information on this subject.)

Statutory limitations on changes in receipts and outlays also influence budget decisions (see "Budget Enforcement" below).

Thus, the budget formulation process involves the simultaneous consideration of the resource needs of individual programs, the allocation of resources among the agencies and functions of the Federal Government, the total outlays and receipts that are appropriate in relation to current and prospective economic conditions, and statutory constraints.

The law governing the President's budget specifies that the President is to transmit the budget to Congress on or after the first Monday in January but not later than the first Monday in February of each year for the following fiscal year, which begins on October 1. The budget is routinely sent to Congress on the first Monday in February, giving it eight months to act on the budget before the fiscal year begins.

In some years, for various reasons, the President cannot adhere to the normal schedule. One reason is that the current law does not require an outgoing President to transmit a budget, and it is impracticable for an incoming President to complete a budget within a few days of taking office on January 20th. President Clinton, the first President subject to the current requirement, submitted a report to Congress on February 17, 1993, describing the comprehensive economic plan he proposed for the Nation and containing summary budget information. He transmitted the Budget of the United States for 1994 on April 8, 1993. President George W. Bush similarly submitted an initial document, *A Blueprint for New Beginnings-A Responsible Budget for America's Priorities,* to Congress on February 28, 2001, and transmitted the Budget of the United States Government for Fiscal Year 2002 on April 9, 2001.

In some years, the late or pending enactment of appropriations acts, other spending legislation, and tax laws considered in the previous budget cycle have delayed preparation and transmittal of complete budgets. For this reason, for example, President Reagan submitted his budget for 1988 forty-five days after the date specified in law. In other years, Presidents have submitted abbreviated budget documents on the due date, sending the more detailed documents weeks later. For example, President Clinton transmitted an abbreviated budget document to Congress on February 5, 1996, because of uncertainty over 1996 appropriations as well as possible changes in mandatory programs and tax policy. He transmitted a budget supplement and other budget volumes in March 1996.

Congressional Action [1]

Congress considers the President's budget proposals and approves, modifies, or disapproves them. It can change funding levels, eliminate programs, or add programs not requested by the President. It can add or eliminate taxes and other sources of receipts, or make other changes that affect the amount of receipts collected.

Congress does not enact a budget as such. Through the process of adopting a budget resolution (described below), it agrees on levels for total spending and receipts, the size of the deficit or surplus, and the debt limit. The budget resolution then provides the framework within which congressional committees prepare appropriations bills and other spending and receipts legislation. Congress provides spending authority for specified purposes in several regular appropriations acts each year (traditionally thirteen). It also enacts changes each year in other laws that affect spending and receipts. Both appropriations acts and these other laws are discussed in the following paragraphs.

In making appropriations, Congress does not vote on the level of outlays (spending) directly, but rather on budget authority, which is the authority provided by law to incur financial obligations that will result in outlays. In a separate process, prior to making appropriations, Congress usually enacts legislation that authorizes an agency to carry out particular programs and, in some cases, limits the amount that can be appropriated for the programs. Some authorizing legislation expires after one year, some expires after a specified number of years, and some is permanent. Congress may enact appropriations for a program even though there is no specific authorization for it.

Congress begins its work on the budget shortly after it receives the President's budget. Under the procedures established by the Congressional Budget Act of 1974, Congress decides on budget totals before completing action on individual appropriations. The Act requires each standing committee of the House and Senate to recommend budget levels and report legislative plans concerning matters within the committee's jurisdiction to the Budget Committee in each body. The Budget Committees then initiate the concurrent resolution on the budget. The budget resolution sets levels for total receipts and for budget authority and outlays, both in total and by functional category (see "Functional Classification" below). It also sets levels for the budget deficit or surplus and debt.

In the report on the budget resolution, the Budget Committees allocate the total budget authority and outlays provided in the resolution to the Appropriations Committees and the other committees that have jurisdiction over spending. The Appropriations Committees are required, in turn, to divide their allocations of budget authority and outlays among their respective subcommittees. The subcommittees may not exceed their allocations in drafting spending bills. The other committees with jurisdiction over spending and receipts may make allocations among their subcommittees but are not required to. The Budget Committees' reports may

[1] For a fuller discussion of the congressional budget process, see Robert Keith and Allen Schick, Manual on the Federal Budget Process (Congressional Research Service Report 98–720 GOV, August 28, 1998) and Introduction to the Federal Budget Process (Congressional Research Service Report 98–721 GOV, December 31, 2003).

discuss assumptions about the level of funding for major programs. While these assumptions do not bind the other committees and subcommittees, they may influence their decisions. The budget resolution may contain "reconciliation directives" (discussed below) to the committees responsible for tax laws and for spending not controlled by annual appropriation acts, in order to conform the level of receipts and this type of spending to the levels specified in the budget resolution.

The congressional timetable calls for the whole Congress to adopt the budget resolution by April 15 of each year, but Congress regularly misses this deadline. Once Congress passes a budget resolution, a member of Congress can raise a point of order to block a bill that would exceed a committee's allocation.

Since the concurrent resolution on the budget is not a law, it does not require the President's approval. However, Congress considers the President's views in preparing budget resolutions, because legislation developed to meet congressional budget allocations does require the President's approval. In some years, the President and the joint leadership of Congress have formally agreed on plans to reduce the deficit or balance the budget. These agreements were reflected in the budget resolution and legislation passed for those years.

Once Congress approves the budget resolution, it turns its attention to enacting appropriations bills and authorizing legislation. Appropriations bills are initiated in the House. They provide the budget authority for the majority of Federal programs. The Appropriations Committee in each body has jurisdiction over annual appropriations. These committees are divided into subcommittees that hold hearings and review detailed budget justification materials prepared by the agencies within the subcommittee's jurisdiction. After a bill has been drafted by a subcommittee, the committee and the whole House, in turn, must approve the bill, usually with amendments to the original version. The House then forwards the bill to the Senate, where a similar review follows. If the Senate disagrees with the House on particular matters in the bill, which is often the case, the two bodies form a conference committee (consisting of Members of both bodies) to resolve the differences. The conference committee revises the bill and returns it to both bodies for approval. When the revised bill is agreed to, first in the House and then in the Senate, Congress sends it to the President for approval or veto.

The President can only approve or veto an entire bill, he cannot approve or veto selected parts. In 1996, Congress enacted the Line Item Veto Act, granting the President limited authority to cancel new spending and limited tax benefits when he signs laws enacted by the Congress. However, in 1998, the Supreme Court declared this authority to be unconstitutional.

For 21 of the last 23 fiscal years, including 2004, some or all of the appropriations bills were not enacted by the beginning of the year. When this occurs, Congress usually enacts a joint resolution called a "continuing resolution," which is an interim appropriations bill, to provide authority for the affected agencies to continue operations at some specified level up to a specific date or until the regular appropriations are enacted. In some years, a continuing resolution has funded a portion or all of the Government for the entire year. Congress must present these resolutions to the President for approval or veto. In some cases, Presidents have rejected continuing resolutions because they contained unacceptable provisions. Left without funds, Government agencies were required by law to shut down operations-with exceptions for some activities-until Congress passed a continuing resolution the President would approve. Shutdowns have lasted for periods of a day to several weeks.

As explained earlier, Congress also provides budget authority in laws other than appropriations acts. In fact, while annual appropriations acts control the spending for the majority of Federal programs, they control only one-third of the total spending in a typical year. Permanent laws, called authorizing legislation, control the rest of the spending. A distinctive feature of these laws is that they provide agencies with the authority to collect or to spend money without first requiring the Appropriations Committees to enact funding. This category of spending includes interest the Government pays on the public debt and the spending of several major programs, such as Social Security, Medicare and Medicaid, unemployment insurance, and Federal employee retirement. This chapter discusses the control of budget authority and outlays in greater detail under BUDGET AUTHORITY AND OTHER BUDGETARY RESOURCES, OBLIGATIONS, AND OUTLAYS.

Almost all taxes and most other receipts result from permanent laws. Article I, Section 7, of the Constitution provides that all bills for raising revenue shall originate in the House of Representatives. In the House, the Ways and Means Committee initiates tax bills; in the Senate, the Finance Committee has jurisdiction over tax laws.

The budget resolution often includes reconciliation directives, which require authorizing committees to change permanent laws that affect receipts and outlays. They direct each designated committee to report amendments to the laws under the committee's jurisdiction that would change the levels of receipts and spending controlled by the laws. The directives specify the dollar amount of changes that each designated committee is expected to achieve, but do not specify which laws are to be changed or the changes to be made. However, the Budget Committees' reports on the budget resolution frequently discuss assumptions about how the laws would be changed. Like other assumptions in the report, they do not bind the committees of jurisdiction but may influence their decisions.

The committees subject to reconciliation directives draft the implementing legislation. Such legislation may, for example, change the tax code, revise benefit formulas or eligibility requirements for benefit programs, or authorize Government agencies to charge fees to cover some of their costs. In some years, Congress has enacted an omnibus budget reconciliation act, which combines the amendments to implement reconciliation directives in a single act. These acts, together with appropriations acts for the year, often implement agreements between the President and the Congress. They may include other matters, such as laws providing the means for enforcing these agreements, as described below.

Budget Enforcement

The Budget Enforcement Act (BEA), first enacted in 1990 and extended in 1993 and 1997, significantly amended the laws pertaining to the budget process, including the Congressional Budget Act, the Balanced Budget and Emergency Deficit Control Act, and the law pertaining to the President's budget (see PRINCIPAL BUDGET LAWS, later in the chapter). The BEA constrained legislation enacted through 2002 that would increase spending or decrease receipts.

The BEA divided spending into two types–discretionary spending and direct spending. Discretionary spending is controlled through annual appropriations acts. Direct spending, which is more commonly referred to as mandatory spending, is controlled by permanent laws. The BEA required budget authority provided in annual appropriations acts for certain specifically identified programs to be treated as mandatory. This is because the authorizing legislation in these cases entitles beneficiaries to receive payment or otherwise obligates the Government to make payment, even though the payments are funded by a subsequent appropriation. Since the authorizing legislation effectively determines the amount of budget authority required, the BEA classified it as mandatory.

The BEA defined categories of discretionary spending and specified dollar limits known as ***"caps"*** on the amount of spending in each category. If the amount of budget authority or outlays provided in appropriations acts for a given year exceeded the cap for that category, the BEA required a procedures, called sequestration, for reducing the spending in the category.

The BEA did not cap mandatory spending. Instead, it required that all laws that affected mandatory spending or receipts be enacted on a ***"pay-as-you-go" (PAYGO)*** basis. That means that if such a law increased the deficit or reduced a surplus in the budget year or any of the four following years, another law had to be enacted with an offsetting reduction in spending or increase in receipts for each year that was affected. Otherwise, a sequestration would be triggered in the fiscal year in which the deficit would be increased.

Chapter 24, "Budget System and Concepts and Glossary," pages 460–461 in the *Analytical Perspectives* volume of the 2004 budget, discusses the Budget Enforcement Act in more detail.

The BEA expired at the end of 2002. The Administration proposes to extend the BEA's mechanisms for limiting discretionary spending for 2004–2009 that would be adhered to throughout the budget process. The Administration also proposes to establish mandatory spending controls and a new mechanism to measure the Federal Government's long-term unfunded obligations and to prohibit increases in those obligations. These proposals are discussed in more detail in the Ensuring Fiscal Responsibility chapter of the *budget* and in Chapter 14. "Budget Reform Proposals," of the *Analytical Perspectives* volume.

Budget Execution

Government agencies may not spend or obligate more than Congress has appropriated, and they may use funds only for purposes specified in law. The Antideficiency Act prohibits them from spending or obligating the Government to spend in advance of an appropriation, unless specific authority to do so has been provided in law. Additionally, the Act requires the President to apportion the budgetary resources available for most executive branch agencies. The President has delegated this authority to OMB. Some apportionments are by time periods (usually by quarter of the fiscal year), some are by projects or activities, and others are by a combination of both. Agencies may request OMB to reapportion funds during the year to accommodate changing circumstances. This system helps to ensure that funds are available to cover operations for the entire year.

During the budget execution phase, the Government sometimes finds that it needs to spend more money than Congress has appropriated for the fiscal year because of unanticipated circumstances. For example, more money might be needed to respond to a severe natural disaster. Under such circumstances, Congress may enact a supplemental appropriation.

On the other hand, changing circumstances may reduce the need to spend appropriated funds. Under the requirements of the Impoundment Control Act of 1974, the President cannot simply decline to spend appropriations. The President may defer spending or propose rescissions. Deferrals, which are temporary withholdings, take effect immediately unless overturned by an act of Congress. The President may only defer funds to provide for contingencies, to achieve savings made possible through changes in requirements or greater efficiency of operations, or as otherwise specifically provided in law. He may not defer funds for policy reasons. In 2003, no deferrals were proposed. Rescissions, which permanently cancel budget authority, take effect only if Congress passes a law approving them. The law may approve only part of a rescission. If Congress does not pass such a law within 45 days of continuous session, the President must make the funds available for spending. The President may propose a rescission for any reason. In total, Congress has rescinded about one-third of the amount of funds that Presidents have proposed for rescission since enactment of the Impoundment Control Act. In 2003, no rescissions were proposed by the President although Congress initiated and enacted rescissions.

Budget Calendar

The following timetable highlights the scheduled dates for significant budget events during the year.

Between the 1st Monday in January and the 1st Monday in February	President transmits the budget.
Six weeks later	Congressional committees report budget estimates to Budget Committees.
April 15	Action to be completed on congressional budget resolution.
May 15	House consideration of annual appropriations bills may begin.
June 15	Action to be completed on reconciliation.
June 30	Action on appropriations to be completed by House.
July 15	President transmits Mid-Session Review of the budget.
October 1	Fiscal year begins.
15 days after the end of a session of Congress	OMB issues final sequestration report, and the President issues a sequestration order, if necessary.

COVERAGE OF THE BUDGET

Federal Government and Budget Totals

Table 25–1. TOTALS FOR THE BUDGET AND THE FEDERAL GOVERNMENT

(In billions of dollars)

	2003 actual	Estimate	
		2004	2005
Budget authority			
Unified	2,266	2,345	2,355
On-budget	1,891	1,956	1,958
Off-budget	376	389	397
Receipts:			
Unified	1,782	1,798	2,036
On-budget	1,258	1,264	1,461
Off-budget	524	534	575
Outlays:			
Unified	2,158	2,319	2,400
On-budget	1,795	1,939	2,004
Off-budget	363	380	396
Surplus:			
Unified	–375	–521	–364
On-budget	–536	–675	–543
Off-budget	161	154	179

The budget documents provide information on all Federal agencies and programs. However, because the laws governing Social Security (the Federal Old-Age and Survivors Insurance and the Federal Disability Insurance trust funds) and the Postal Service Fund exclude the receipts and outlays for those activities from the budget totals and from the calculation of the deficit or surplus, the budget presents on-budget and off-budget totals. The off-budget totals include the transactions excluded by law from the budget totals. The on-budget and off-budget amounts are added together to derive the totals for the Federal Government. These are sometimes referred to as the unified or consolidated budget totals.

It is not always obvious whether a transaction or activity should be included in the budget. Where there is a question, we normally follow the recommendation of the 1967 President's Commission on Budget Concepts to be comprehensive of the full range of Federal agencies, programs, and activities. In recent years, for example, the budget has included the transactions of the Universal Service Fund, the Public Company Accounting Oversight Board, Guaranty Agencies Reserves, the National Railroad Retirement Investment Trust, and the United Mine Workers Combined Benefits Fund.

Beginning in 2003, the budget includes the transactions of the Telecommunications Development Fund (TDF), which was established in 1996 pursuant to the Telecommunications Act of 1996, starting in 2003. The statute states that the TDF is a private corporation. However, its funding and activities are governmental in nature and its policies and operations are largely controlled by the Federal government. The TDF has the authority to spend the interest earned on deposits required of bidders by the Federal Communications Commission (FCC) as part of the spectrum auction process. The interest earnings are used as venture capital for small businesses and spent on other activities related to telecommunications services. The TDF's board members are appointed by the Chairman of the FCC and include representatives of the FCC, Treasury, and Small Business Administration. Treasury must report annually to the President and Congress on the operations and financial condition of the fund. Despite its designation as a private corporation, it has no publicly owned shares.

In contrast, the budget excludes tribal trust funds that are owned by Indian tribes and held and managed by the Government in a fiduciary capacity on the tribes' behalf. These funds are not owned by the Government, the Government is not the source of their capital, and the Government's control is limited to the exercise of fiduciary duties. Similarly, the transactions of Government-sponsored enterprises, such as the Federal National Mortgage Association (Fannie Mae) are not included in the on-budget or off-budget totals. Federal laws established these enterprises for public policy purposes, but they are privately owned and operated corporations. Because of their close relationship to the Government, the budget discusses them and reports their financial data in the budget *Appendix* and in some detailed tables.

The *Appendix* includes a presentation for the Board of Governors of the Federal Reserve System for information only. The amounts are not included in either the on-budget or off-budget totals because of the independent status of the System within the Government. However, the Federal Reserve System transfers its net earnings to the Treasury, and the budget records them as receipts.

Functional Classification

The functional classification arrays budget authority, outlays, and other budget data according to the major purpose served-such as agriculture, income security, and national defense. There are nineteen major functions, most of which are divided into subfunctions. For example, the Agriculture function comprises the subfunctions Farm Income Stabilization and Agricultural Research and Services. The functional classification is an integral part of the congressional budget process, and the functional array meets the Congressional Budget Act requirement for a presentation in the budget by national needs and agency missions and programs.

The following criteria are used in establishing functional categories and assigning activities to them:

- A function encompasses activities with similar purposes, emphasizing what the Federal Government seeks to accomplish rather than the means of accomplishment, the objects purchased, the clientele or geographic area served, or the Federal agency conducting the activity.
- A function must be of continuing national importance, and the amounts attributable to it must be significant.
- Each basic unit being classified (generally the appropriation or fund account) usually is classified according to its primary purpose and assigned to only one subfunction. However, some large accounts that serve more than one major purpose are subdivided into two or more subfunctions.

Detailed functional tables, which provide information on government activities by function and subfunction, appear this year on the Analytical Perspectives CD ROM as Table 26.

Agencies, Accounts, Programs, Projects, and Activities

Various summary tables in the *Analytical Perspectives* volume of the budget provide information on budget authority, outlays, and offsetting collections and receipts arrayed by Federal agency. A table that lists budget authority and outlays by budget account within each agency and the totals for each agency of budget authority, outlays, and receipts that offset the agency spending totals appears this year on the Analytical Perspectives CD ROM as Table 27–1. The *Appendix* provides budgetary, financial, and descriptive information about programs, projects, and activities by account within each agency. The *Appendix* also presents the most recently enacted appropriation language for an account and any changes that are proposed to be made for the budget year.

Types of Funds

Agency activities are financed through Federal funds and trust funds.

Federal funds comprise several types of funds. Receipt accounts of the ***general fund***, which is the greater part of the budget, record receipts not earmarked by law for a specific purpose, such as income tax receipts. The general fund also includes the proceeds of general borrowing. General fund appropriation accounts record general fund expenditures. General fund appropriations draw from general fund receipts and borrowing collectively and, therefore, are not specifically linked to receipt accounts. ***Special funds*** consist of receipt accounts for Federal fund receipts that laws have earmarked for specific purposes and the associated appropriation accounts for the expenditure of those receipts. ***Public enterprise*** funds are revolving funds used for programs authorized by law to conduct a cycle of business-type operations, primarily with the public, in which outlays generate collections. ***Intragovernmental funds*** are revolving funds that conduct business-type operations primarily within and between Government agencies. The collections and the outlays of revolving funds are recorded in the same budget account.

Trust funds account for the receipt and expenditure of monies by the Government for carrying out specific purposes and programs in accordance with the terms of a statute that designates the fund as a trust fund (such as the Highway Trust Fund) or for carrying out the stipulations of a trust where the Nation is the beneficiary (such as any of several trust funds for gifts and donations for specific purposes). ***Trust revolving funds*** are trust funds credited with collections earmarked by law to carry out a cycle of business-type operations.

The Federal budget meaning of the term “trust,” as applied to trust fund accounts, differs significantly from its private sector usage. In the private sector, the beneficiary of a trust usually owns the trust’s assets, which are managed by a trustee who must follow the stipulations of the trust. In contrast, the Federal Government owns the assets of most Federal trust funds, and it can raise or lower future trust fund collections and payments, or change the purposes for which the collections are used, by changing existing laws. There is no substantive difference between a trust fund and a special fund or between a trust revolving fund and a public enterprise revolving fund. The Government does act as a true trustee of assets that are owned or held for the benefit of others. For example, it maintains accounts on behalf of individual Federal employees in the Thrift Savings Fund, investing them as directed by the individual employee. The Government accounts for such funds in ***deposit funds***, which are not included in the budget. (Chapter 21, "Trust Funds and Federal Funds," provides more information on this subject.)

Budgeting for Full Costs

A budget is a financial plan for allocating resources-deciding how much the Federal Government should spend in total, program by program, and for the parts of each program. The budgetary system provides a process for proposing policies, making decisions, implementing them, and reporting the results. The budget needs to measure costs accurately so that decision makers can compare the cost of a program with its benefit, the cost of one program with another, and the cost of alternative methods of reaching a specified goal. These costs need to be fully included in the budget up front, when the spending decision is made, so that executive and congressional decision makers have the information and the incentive to take the total costs into account for setting priorities.

The budget includes all types of spending, including both current operating expenditures and capital investment, and to the extent possible, both are measured on the basis of full cost. Questions are often raised about the measure of capital investment. The present budget provides policymakers the necessary information regarding investment spending. It records investment on a cash basis, and it requires Congress to provide budget authority before an agency can obligate the Government to make a cash outlay. By these means, it causes the total cost of capital investment to be compared up front in a rough and ready way with the total expected future net benefits. Since the budget measures only cost, the benefits with which these costs are compared, based on policy makers' judgment, must be presented in supplementary materials. Such a comparison of total costs with benefits is consistent with the formal method of cost-benefit analysis of capital projects in government, in which the full cost of a capital asset as the cash is paid out is compared with the full stream of future benefits (all in terms of present values). (Chapter 6, "Federal Investment," provides more information on capital investment.)

There have been a number of proposals to change the basis for measuring capital investment in the budget. Many of these would undermine effective consideration and control of costs by spreading the real cost of the project over time and record as a current operating expense the annual depreciation for each year of an asset's life. No depreciation would be recorded until after the asset was put into service. This could be several years after the initial expenditure, in which case the budget would record no expenses at all in the budget year or several years thereafter, even though the Government is obligated to buy the asset. Recording the annual depreciation in the budget each year would provide little control over the decision about whether to invest in the first place. Control can only be exercised up front when the Government commits itself to the full sunk cost. Spreading the costs over time would make the cost of a capital asset appear very cheap when decisions were being made that compared it to alternative expenditures. As a result, the Government would have an incentive to purchase capital assets with little regard for need, and also with little regard for the least-cost method of acquisition. Chapter 7, "Federal Investment Spending and Capital Budgeting," pages 157–165 in the Analytical Perspectives volume of the 2004 Budget, discusses alternative capital budget and capital expenditure presentations in more detail.

RECEIPTS, OFFSETTING COLLECTIONS, AND OFFSETTING RECEIPTS

In General

The budget records money collected by Government agencies two different ways. Depending on the nature of the activity generating the collection, they are recorded as either:

- ***Receipts***, which are compared in total to outlays (net of offsetting collections and receipts) in calculating the surplus or deficit; or
- ***Offsetting collections*** or ***offsetting receipts***, which are deducted from gross outlays to produce net outlay figures.

Receipts

Receipts are collections that result from the Government's exercise of its sovereign power to tax or otherwise compel payment and gifts of money to the Government. Sometimes they are called governmental receipts to distinguish them from offsetting receipts and sometimes they are called Federal receipts or Federal revenues. They consist mostly of individual and corporation income taxes and social insurance taxes, but also include excise taxes, compulsory user charges, regulatory fees, customs duties, court fines, certain license fees, and deposits of earnings by the Federal Reserve System. Total receipts for the Federal Government include both on-budget and off-budget receipts (see Table 25–1, "Totals for the Budget and the Federal Government," which appears earlier in this chapter.) Chapter 16, "Federal Receipts," provides more information on receipts.

Offsetting Collections and Offsetting Receipts

Offsetting collections and offsetting receipts are recorded as offsets to (deductions from) spending, not as additions on the receipt side of the budget. As explained below, they are recorded as offsets to spending so that the budget totals represent governmental rather than market activity and reflect the Government's net transactions with the public. They are recorded in one of two ways, based on interpretation of laws and longstanding budget concepts and practice. They are offsetting collections when the collections are authorized by law to be credited to expenditure accounts. Otherwise, they are deposited in receipt accounts and called offsetting receipts.

Offsetting collections and offsetting receipts result from one of the following types of transactions:

- ***Business-like transactions or market-oriented activities with the public***—collections from the public in exchange for goods or services. The budget records the proceeds from the sale of postage stamps, the fees charged for admittance to recreation areas, and the proceeds from the sale of Government-owned land, for example, as offsetting collections from non-Federal sources or as proprietary receipts. The amounts are deducted from gross budget authority and outlays, rather than added to receipts. This treatment produces budget totals for receipts, budget authority, and outlays that represent governmental rather than market activity.
- ***Intragovernmental transactions***—collections from other Federal Government accounts. The budget records collections by one Government account from another as *offsetting collections from Federal sources or as intragovernmental receipts*. For example, the General Services Administration rents office space to other Government agencies and records their rental payments as offsetting collections in the Federal Buildings Fund. These transactions are completely offsetting and do not affect the surplus or deficit. However, they are an important accounting mechanism for allocating costs to the programs and activities that cause the Government to incur the costs. Intragovernmental offsetting collections and receipts are deducted from gross budget authority and outlays so that the budget totals measure the transactions of the Government with the public.
- ***Offsetting governmental transactions***—collections from the public that are governmental in nature (e.g., tax receipts, regulatory fees, compulsory user charges, custom duties, license fees) but required by law to be misclassified as offsetting. The budget records amounts from non-Federal sources that are governmental in nature as *offsetting governmental collections or as offsetting governmental receipts*.

A table in Chapter 20, “Outlays to the Public, Net and Gross,” shows the effect of offsetting collections and receipts on gross outlays for each major Federal agency.

Offsetting Collections

Some laws authorize agencies to credit collections directly to the account from which they will be spent and, usually, to spend the collections for the purpose of the account without further action by Congress. Most revolving funds operate with such authority. For example, a permanent law authorizes the Postal Service to use collections from the sale of stamps to finance its operations without a requirement for annual appropriations. The budget records these collections in the Postal Service Fund (a revolving fund) and records budget authority in an amount equal to the collections. In addition to revolving funds, some agencies are authorized to charge fees to defray a portion of costs for a program that are otherwise financed by appropriations from the general fund and usually to spend the collections without further action by Congress. In such cases, the budget records the offsetting collections and resulting budget authority in the program’s general fund expenditure account. Similarly, intragovernmental collections authorized by some laws may be recorded as offsetting collections and budget authority in revolving funds or in general fund expenditure accounts.

Sometimes appropriations acts or provisions in other laws limit the obligations that can be financed by offsetting collections. In those cases, the budget records budget authority in the amount available to incur obligations, not in the amount of the collections.

Where accounts have offsetting collections, the budget shows the budget authority and outlays of the account both gross (before deducting offsetting collections) and net (after deducting offsetting collections). Totals for the agency, subfunction, and budget are net of offsetting collections.Offsetting Receipts

Collections that are offset against gross outlays but are not authorized to be credited to expenditure accounts are credited to receipt accounts and are called offsetting receipts. Offsetting receipts are deducted from budget authority and outlays in arriving at total budget authority and outlays. However, unlike offsetting collections credited to expenditure accounts, offsetting receipts do not offset budget authority and outlays at the account level. In most cases, they offset budget authority and outlays at the agency and subfunction levels.

Proprietary receipts from a few sources, however, are not offset against any specific agency or function and are classified as undistributed offsetting receipts. They are deducted from the Government-wide totals for budget authority and outlays. For example, the collections of rents and royalties from outer continental shelf lands are undistributed because the amounts are large and for the most part are not related to the spending of the agency that administers the transactions and the subfunction that records the administrative expenses.

Similarly, two kinds of intragovernmental transactions—agencies’ payments as employers into Federal employees retirement trust funds and interest received by trust funds—are classified as undistributed offsetting receipts. They appear instead as special deductions in computing total budget authority and outlays for the Government rather than as offsets at the agency level. This special treatment is necessary because the amounts are large and would distort measures of the agency’s activities, if they were attributed to the agency.

User Charges

User charges are fees assessed on individuals or organizations for the provision of Government services and for the sale or use of Government goods or resources. The payers of the user charge must be limited in the authorizing legislation to those receiving special benefits from, or subject to regulation by, the program or activity beyond the benefits received by the general public or broad segments of the public (such as those who pay income taxes or customs duties). User charges are defined and the policy regarding user charges is established in OMB Circular A–25, "User Charges" (July 8, 1993). The term encompasses proceeds from the sale or use of government goods and services, including the sale of natural resources (such as timber, oil, and minerals) and proceeds from asset sales (such as property, plant, and equipment). User charges are not necessarily earmarked for the activity they finance and may be credited to the general fund of the Treasury.

The term "user charge"does not refer to a separate budget category for collections. User charges are classified in the budget as receipts, offsetting receipts, or offsetting collections according to the principles explained above.

See Chapter 17, "User Charges and Other Collections," for more information on the classification of user charges.

BUDGET AUTHORITY AND OTHER BUDGETARY RESOURCES, OBLIGATIONS, AND OUTLAYS

Budget authority, obligations, and outlays are the primary benchmarks and measures of the budget control system. Congress enacts laws that provide agencies with spending authority in the form of budget authority. Before agencies can use the resources, OMB must approve their spending plans. After the plans are approved, agencies can enter into binding agreements to purchase items or services. These agreements are recorded as obligations of the United States and deducted from the amount of budgetary resources available to the agency. When payments are made, the obligations are liquidated and outlays recorded. These concepts are discussed more fully below.

Budget Authority and Other Budgetary Resources

Budget authority is the authority provided in law to enter into legal obligations that will result in immediate or future outlays of the Government. In other words, it is the amount of money that agencies are allowed to commit to be spent in current or future years. Government officials may obligate the Government to make outlays only to the extent they have been granted budget authority. The budget records new budget authority as a dollar amount in the year when it first becomes available. When permitted by law, unobligated balances of budget authority may be carried over and used in the next year. The budget does not record these balances as budget authority again. They do, however, constitute a budgetary resource that is available for obligation. In some cases, a provision of law (such as a limitation on obligations or a benefit formula) precludes the obligation of funds that would otherwise be available for obligation. In such cases, the budget records budget authority equal to the amount of obligations that can be incurred. A major exception to this rule is for the highway and mass transit programs financed by the Highway Trust Fund, where budget authority is measured as the amount of contract authority (described below) provided in authorizing statutes, even though the obligation limitations enacted in annual appropriations acts restrict the amount of contract authority that can be obligated.

In deciding the amount of budget authority to request for a program, project, or activity, agency officials estimate the total amount of obligations they will need to incur to achieve desired goals and subtract the unobligated balances available for these purposes. The amount of budget authority requested is influenced by the nature of the programs, projects, or activities being financed. For current operating expenditures, the amount requested usually covers needs for the year. For major procurement programs and construction projects, agencies generally must request sufficient budget authority in the first year to fully fund an economically useful segment of a procurement or project, even though it may be obligated over several years. This full funding policy is intended to ensure that the decision-makers take into account all costs and benefits fully at the time decisions are made to provide resources. It also avoids sinking money into a procurement or project without being certain if or when future funding will be available to complete the procurement or project.

Budget authority takes several forms:

- ***Appropriations***, provided in annual appropriations acts or permanent laws, permit agencies to incur obligations and make payment;
- ***Authority to borrow***, usually provided in permanent laws, permits agencies to incur obligations but requires them to borrow funds, usually from the general fund of the Treasury, to make payment;
- ***Contract authority***, usually provided in permanent law, permits agencies to incur obligations in advance of a separate appropriation of the cash for payment or in anticipation of the collection of receipts that can be used for payment; and
- ***Spending authority from offsetting collections***, usually provided in permanent law, permits agencies to credit offsetting collections to an expenditure account, incur obligations, and make payment using the offsetting collections.

Because offsetting collections and receipts are deducted from gross budget authority, they are referred to as negative budget authority for some purposes, such as Congressional Budget Act provisions that pertain to budget authority.

Authorizing statutes usually determine the form of budget authority for a program. The authorizing statute may authorize a particular type of budget authority to be provided in annual appropriations acts, or it may provide one of the forms of budget authority directly, without the need for further appropriations.

An appropriation may make funds available from the general fund, special funds, or trust funds, or authorize the spending of offsetting collections credited to expenditure accounts, including revolving funds. Borrowing authority is usually authorized for business-like activities where the activity being financed is expected to produce income over time with which to repay the borrowing with interest. The use of contract authority is traditionally limited to transportation programs.

New budget authority for most Federal programs is normally provided in 13 annually enacted appropriations acts. However, new budget authority for more than half of all outlays is made available through permanent appropriations under existing laws. These permanent appropriations take three main forms. The first is budget authority for trust funds, which for most trust funds is automatically appropriated under existing law from the available balance of their receipts and equals the estimated annual obligations of the funds. The second is interest on the public debt, for which budget authority is automatically provided under a permanent appropriation enacted in 1847 and equals interest outlays. The third is the authority to spend offsetting collections credited to appropriation or fund accounts. Annual appropriations acts generally make budget authority available for obligation only during the fiscal year to which the act applies. However, they frequently allow budget authority for a particular purpose to remain available for obligation for a longer period or indefinitely (that is, until expended or until the program objectives have been attained). Typically, budget authority for current operations is made available for only one year, and budget authority for construction and some research projects is available for a specified number of years or indefinitely. Budget authority provided in authorizing statutes, such as for most trust funds, is available indefinitely. Only another law can extend a limited period of availability (see "Reappropriation" below).

Budget authority that is available for more than one year and not obligated in the year it becomes available is carried forward for obligation in a following year. In some cases, an account may carry forward unobligated budget authority from more than one year. The sum of such amounts constitutes the account's ***unobligated balance.*** Most of this budget authority is earmarked for specific uses and is not available for new programs. A small part may never by obligated or spent, primarily amounts provided for contingencies that do not occur or reserves that never have to be used.

Budget authority that has been obligated but not paid constitutes the account's ***unpaid obligations***. For example, in the case of salaries and wages, one to three weeks elapse between the time of obligation and the time of payment. In the case of major procurement and construction, payments may occur over a period of several years after the obligation is made. Unpaid obligations net of the accounts receivable and unfilled customers orders are defined by law as the ***obligated balances***. Obligated balances of budget authority at the end of the year are carried forward until the obligations are paid or the balances are canceled. (A general law cancels the obligated balances of budget authority that was made available for a definite period five years after the end of the period, and then other resources must be used to pay the obligations.) Due to such flows, a change in the amount of budget authority available in any one year may change the level of obligations and outlays for several years to come. Conversely, a change in the amount of obligations incurred from one year to the next does not necessarily result from an equal change in the amount of budget authority available for that year and will not necessarily result in an equal change in the level of outlays in that year.[2]

Congress usually makes budget authority available on the first day of the fiscal year for which the appropriations act is passed. Occasionally, the appropriations language specifies a different timing. The language may provide an ***advance appropriation***—budget authority that does not become available until one year or more beyond the fiscal year for which the appropriations act is passed. ***Forward funding*** is budget authority that is made available for obligation beginning in the last quarter of the fiscal year (beginning on July 1st) for the financing of ongoing grant programs during the next fiscal year. This kind of funding is used mostly for education programs, so that obligations for grants can be made prior to the beginning of the next school year. For certain benefit programs funded by annual appropriations, the appropriation provides for ***advance funding***—budget authority that is to be charged to the appropriation in the succeeding year but which authorizes obligations to be incurred in the last quarter of the current fiscal year if necessary to meet benefit payments in excess of the specific amount appropriated for the year.

Provisions of law that extend the availability of unobligated amounts that have expired or would otherwise expire are called ***reappropriations***. Reappropriations of expired balances that are newly available for obligation in the current or budget year count as new budget authority in the fiscal year in which the balances become newly available. For example, if a 2004 appropriations act extends the availability of unobligated budget

[2] A separate report, "Balances of Budget Authority," provides additional information on balances. The National Technical Information Service, Department of Commerce, makes the report available shortly after the budget is transmitted.

authority that expired at the end of 2003, new budget authority would be recorded for 2004.

For purposes of the Budget Enforcement Act (discussed earlier under "Budget Enforcement"), the budget classifies budget authority as ***discretionary*** or ***mandatory***. This classification indicates whether appropriations acts or authorizing legislation control the amount of budget authority that is available. Outlays are also classified as discretionary or mandatory according to the classification of the budget authority from which they flow (see "Outlays" below).

Generally, budget authority is discretionary if provided in an annual appropriations act and mandatory if provided in authorizing legislation. However, the BEA requires the budget authority provided in annual appropriations acts for certain specifically identified programs to be classified as mandatory. This is because the authorizing legislation for these programs entitles beneficiaries to receive payment or otherwise obligates the Government to make payment and effectively determines the amount of budget authority required, even though the payments are funded by a subsequent appropriation.

The amount of budget authority recorded in the budget depends on whether the law provides a specific amount or specifies a variable factor that determines the amount. It is considered ***definite*** if the law specifies a dollar amount (which may be an amount not to be exceeded). It is considered ***indefinite*** if, instead of specifying an amount, the law permits the amount to be determined by subsequent circumstances. For example, indefinite budget authority is provided for interest on the public debt, payment of claims and judgments awarded by the courts against the U.S., and many entitlement programs. Many of the laws that authorize collections to be credited to revolving, special, and trust funds make all of the collections available for expenditure for the authorized purposes of the fund, and such authority is considered to be indefinite budget authority.

Obligations Incurred

Following the enactment of budget authority and the completion of required apportionment action, Government agencies incur obligations to make payments (see earlier discussion under "Budget Execution"). Agencies must record obligations when they enter into binding agreements that will result in immediate or future outlays. Such obligations include the current liabilities for salaries, wages, and interest; and contracts for the purchase of supplies and equipment, construction, and the acquisition of office space, buildings, and land. For Federal credit programs, obligations are recorded in an amount equal to the estimated subsidy cost of direct loans and loan guarantees (see FEDERAL CREDIT below).

Outlays

Outlays are the measure of Government spending. They are payments that liquidate obligations (other than the repayment of debt). The budget records them when obligations are paid, in the amount that is paid.

Agency, function, and subfunction, and Government-wide outlay totals are stated net of offsetting collections and offsetting receipts for most budget presentations. (Offsetting receipts from a few sources do not offset any specific function, subfunction, or agency but only offset Government-wide totals.) Outlay totals for accounts with offsetting collections are stated both gross and net of the offsetting collections credited to the account. However, the outlay totals for special and trust funds with offsetting receipts are not stated net of the offsetting receipts.

The Government usually makes outlays in the form of cash (currency, checks, or electronic fund transfers). However, in some cases agencies pay obligations without disbursing cash and the budget records outlays nevertheless for the equivalent method. For example, the budget records outlays for the full amount of Federal employees' salaries, even though the cash disbursed to employees is net of Federal and state income taxes, retirement contributions, life and health insurance premiums, and other deductions. (The budget also records receipts for the deductions of Federal income taxes and other payments to the Government.) When debt instruments (bonds, debentures, notes, or monetary credits) are used in place of cash to pay obligations, the budget records outlays financed by an increase in agency debt. For example, the budget records the acquisition of physical assets through certain types of lease-purchase arrangements as though a cash disbursement were made for an outright purchase. The transaction creates a Government debt, and the cash lease payments are treated as repayments of principal and interest.

The measurement of interest varies. The budget records outlays for the interest on the public issues of Treasury debt securities as the interest accrues, not when the cash is paid. A small portion of this debt consists of inflation-indexed securities, which feature monthly adjustments to principal for inflation and semiannual payments of interest on the inflation-adjusted principal. As with fixed-rate securities, the budget records interest outlays as the interest accrues. The monthly adjustment to principal is recorded, simultaneously, as an increase in debt outstanding and an outlay of interest.

Most Treasury debt securities held by trust funds and other Government accounts are in the Government account series (special issues). The budget normally states the interest on these securities on a cash basis. When a Government account is invested in Federal debt securities, the purchase price is usually close or identical to the par (face) value of the security. The budget records the investment at par value and adjusts the interest paid by Treasury and collected by the account by the difference between purchase price and par, if any. However, two trust funds in the Department of Defense, the Military Retirement Trust Fund and the Education Benefits Trust Fund, routinely have relatively large differences between purchase price and par. For these funds, the budget records the holdings of debt at par but records the differences between purchase price and par as adjustments to the assets of the funds that are amortized over the life of the security. The budget records interest as the amortization occurs.

For Federal credit programs, outlays are equal to the subsidy cost of direct loans and loan guarantees and are recorded as the underlying loans are disbursed (see FEDERAL CREDIT below).

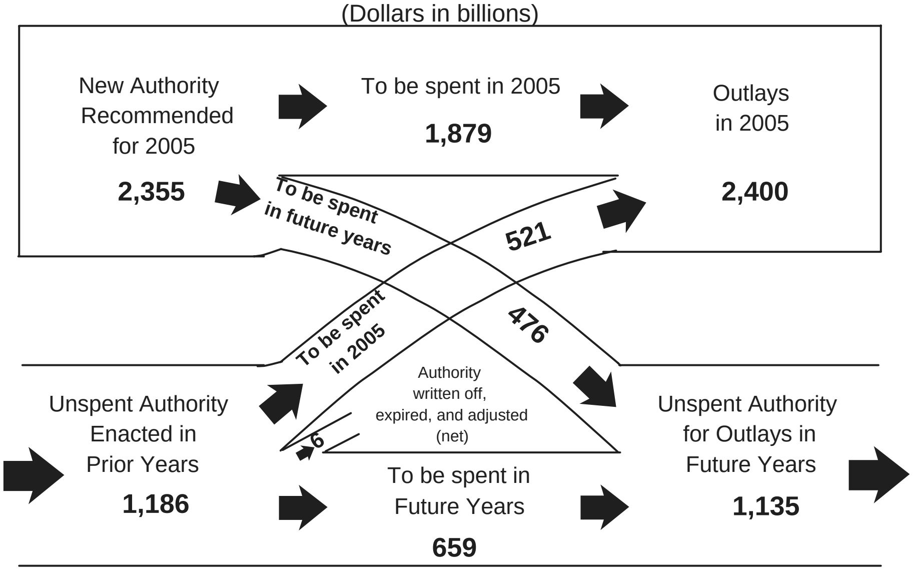
The budget records refunds of receipts that result from overpayments (such as income taxes withheld in excess of tax liabilities) as reductions of receipts, rather than as outlays. However, the budget records payments to taxpayers for refundable tax credits (such as earned income tax credits) that exceed the taxpayer's tax liability as outlays. Refunds of overpayments by the Government are recorded as offsetting collections or offsetting receipts.

Not all of the new budget authority for 2005 will be obligated or spent in 2005. Outlays during a fiscal year may liquidate obligations incurred in the same year or in prior years. Obligations, in turn, may be incurred against budget authority provided in the same year or against unobligated balances of budget authority provided in prior years. Outlays, therefore, flow in part from budget authority provided for the year in which the money is spent and in part from budget authority provided in prior years. The ratio of the outlays resulting from budget authority enacted in a given year to the amount of that budget authority is referred to as the spendout rate for that year.

As shown in the following chart, $521 billion of outlays in 2005 (22 percent of the total) will be made from budget authority enacted in previous years. At the same time, $476 billion of the new budget authority proposed for 2005 (20 percent of the total amount proposed) will not lead to outlays until future years. In general, the total budget authority for a particular year is not directly indicative of that year's outlays since it combines various types of budget authority that have different short-term and long-term implications for budget obligations and outlays.

Chart 25-1. Relationship of Budget Authority to Outlays for 2005

(Dollars in billions)


New Authority Recommended for 2005
2,355
To be spent in 2005
1,879
Outlays in 2005
2,400
To be spent in future years
521
476
To be spent in 2005
Authority written off, expired, and adjusted (net)
6
Unspent Authority Enacted in Prior Years
1,186
To be spent in Future Years
659
Unspent Authority for Outlays in Future Years
1,135

As described earlier, the budget classifies budget authority and outlays as discretionary or mandatory for the purposes of the BEA. This classification of outlays measures the extent to which actual spending is controlled through the annual appropriations process. Typically, only one-third ($826 billion in 2003) of total outlays for a fiscal year are discretionary and the remaining two-thirds ($1,332 billion in 2003) consists of mandatory spending and net interest. Such a large portion of total spending is nondiscretionary because authorizing legislation determines net interest ($153 billion in 2003) and the spending for a few programs with large amounts of spending each year, such as Social Security ($470 billion in 2003) and Medicare ($246 billion in 2003).

The bulk of mandatory outlays flows from an equal amount of budget authority recorded in the same fiscal year. This is not the case for discretionary budget authority and outlays. For most major construction and procurement projects and long-term contracts, for example, the budget authority covers the entire cost estimated when the projects are initiated even though the work wil take place and outlays will be made over a period extending beyond the year for which the budget authority is enacted. Similarly, discretionary budget authority for most education and job training activities is appropriated for school or program years that begin in the fourth quarter of the fiscal year. most of these funds result in outlays in the year after the appropriation.

FEDERAL CREDIT

Some Government programs make direct loans or loan guarantees. A ***direct loan*** is a disbursement of funds by the Government to a non-Federal borrower under a contract that requires repayment of such funds with or without interest. The term includes equivalent transactions such as selling a property on credit terms in lieu of receiving cash up front. A ***loan guarantee*** is any guarantee, insurance, or other pledge with respect to the payment of all or a part of the principal or interest on any debt obligation of a non-Federal borrower to a non-Federal lender. The Federal Credit Reform Act (FCRA) prescribes the budget treatment for Federal credit programs. Under this treatment, the budget records the net cost to the Government (subsidy cost) when the loans are disbursed, rather than the cash flows year-by-year over the term of the loan, so direct loans and loan guarantees can be compared to each other and to other methods of delivering benefits, such as grants, on an equivalent basis.

The cost of direct loans and loan guarantees, sometimes called the “subsidy cost,” is estimated as the present value of expected disbursements over the term of the loan less the present value of expected collections.[4] As for most other kinds of programs, agencies can make loans or guarantee loans only if Congress has appropriated funds sufficient to cover the subsidy costs in annual appropriations acts.

The budget records the estimated long-term cost to the Government arising from direct loans and loan guarantees in ***credit program accounts***. When a Federal agency disburses a direct loan or when a non-Federal lender disburses a loan guaranteed by a Federal agency, the program account outlays an amount equal to the cost to a non-budgetary ***credit financing account***. The financing accounts record the actual transactions with the public. For a few programs, the estimated cost is negative, because the present value of expected collections exceeds the present value of expected disbursements over the term of the loan. In such cases, the financing account makes a payment to the program’s receipt account, where it is recorded as an offsetting receipt. In a few cases, the receipts are earmarked in a special fund established for the program and are available for appropriation for the program.

The agencies responsible for credit programs must reestimate the cost of the outstanding direct loans and loan guarantees each year. If the estimated cost increases, the program account makes an additional payment to the financing account. If the estimated cost decreases, the financing account makes a payment to the program’s receipt account, where it is recorded as an offsetting receipt. The FCRA provides permanent indefinite appropriations to pay for upward reestimates.

If the Government modifies the terms of an outstanding direct loan or loan guarantee in a way that increases the cost, as the result of a law or the exercise of administrative discretion under existing law, the program account records obligations for an additional amount equal to the increased cost and outlays the amount to the financing account. As with the original cost, agencies may incur modification costs only if Congress has appropriated funds to cover them. Modification may also reduce costs, in which case the financing account makes a payment to the program’s receipt account.

Credit financing accounts record all cash flows to and from the Government arising from direct loan obligations and loan guarantee commitments. These cash flows consist mainly of direct loan disbursements and repayments, loan guarantee default payments, fees and interest from the public, the receipt of subsidy cost payments from program accounts, and interest paid to or received from Treasury. Separate financing accounts record the cash flows of direct loans and of loan guarantees for programs that provide both types of credit. The budget totals exclude the transactions of financing accounts because they are not a cost to the Government. However, since financing accounts record cash flows to and from the Government, they affect the means of financing a budget surplus or deficit (see “Credit Financing Accounts” in the next section). The budget documents display the transactions of the financing accounts, together with the related program accounts, for information and analytical purposes.

[4] Present value is a standard financial concept that allows for the time value of money, that is, for the fact that a given sum of money is worth more at present than in the future because interest can be earned on it.

The FCRA, which was enacted in 1990, grandfathered direct loan obligations and loan guarantee commitments made prior to 1992. The budget records these on a cash basis in credit liquidating accounts, the same as they were recorded before FCRA was enacted. However, this exception ceases to apply if the direct loans or loan guarantees are modified as described above. In that case, the budget records a modification subsidy cost or savings, as appropriate, and begins to account for the associated transactions as the FCRA prescribes for direct loan obligations and loan guarantee commitments made in 1992 or later.

BUDGET DEFICIT OR SURPLUS AND MEANS OF FINANCING

When outlays exceed receipts, the difference is a deficit, which the Government finances primarily by borrowing. When receipts exceed outlays, the difference is a surplus, and the Government uses the surplus primarily to reduce debt. The Government's debt (debt held by the public) is approximately the cumulative amount of borrowing to finance deficits, less repayments from surpluses. Borrowing is not exactly equal to the deficit, and debt repayment is not exactly equal to the surplus, because of the other means of financing such as those discussed under this heading. Some, such as the net disbursements of the direct loan financing account, normally increase the Government's borrowing needs or decrease its ability to repay debt; others normally have the opposite effect or may be either positive or negative. In some years, such as 2003, the net effect of the other means of financing is minor relative to the borrowing or debt repayment; in other years, such as 2002, the net effect may be significant.

Borrowing and Debt Repayment

The budget treats borrowing and debt repayment as a means of financing, not as receipts and outlays. If borrowing were defined as receipts and debt repayment as outlays, the budget would be virtually balanced by definition. This rule applies both to borrowing in the form of Treasury securities and to specialized borrowing in the form of agency securities (including the issuance of debt securities to liquidate an obligation and the sale of certificates representing participation in a pool of loans). In 2003, the Government borrowed $373 billion from the public. This financed nearly all of the $375 billion deficit in that year. The rest of the deficit was financed by the net effect of the other means of financing, such as changes in cash balances and other accounts discussed below. At the end of 2003, the debt held by the public was $3,914 billion.

In addition to selling debt to the public, the Treasury Department issues debt to Government accounts, primarily trust funds that are required by law to invest in Treasury securities. Issuing and redeeming this debt does not affect the means of financing, because these transactions occur between one Government account and another and thus do not raise or use any cash for the Government as a whole. (See Chapter 15, "Federal Borrowing and Debt," for a fuller discussion of this topic.)

Debt Buyback Premiums

From 2000 through April 2002, the Treasury Department bought back outstanding U.S. Treasury bonds as part of its efforts to manage efficiently the publicly held debt. Because interest rates were lower than the coupon rates on the bonds that Treasury bought back, the government had to pay a premium over the book value of these securities. This buyback premium is recorded as a means of financing, not as outlays. Chapter 24, "Budget System and Concepts and Glossary," pages 457–458 in the Analytical Perspectives volume of the 2001 Budget, discusses the basis for this treatment in more detail, including an examination of the alternatives that were considered.

Exercise of Monetary Power

Seigniorage is the profit from coining money. It is the difference between the value of coins as money and their cost of production. Seigniorage adds to the Government's cash balance, but unlike the payment of taxes or other receipts, it does not involve a transfer of financial assets from the public. Instead, it arises from the exercise of the Government's power to create money and the public's desire to hold financial assets in the from of coins. Therefore, the budget excludes seigniorage from receipts and treats it as a means of financing other than borrowing from the public. The budget also treats profits resulting from the sale of gold as a means of financing, since the value of gold is determined by its value as a monetary asset rather than as a commodity.

Credit Financing Accounts

The budget records the net cash flows of credit programs in credit financing accounts. They are excluded from the budget because they are not allocations of resources by the Government (see FEDERAL CREDIT above). However, even though they do not affect the surplus or deficit, they can either increase or decrease the Government's need to borrow. Therefore, they are recorded as a means of financing.

Financing account disbursements to the public increase the requirement for Treasury borrowing in the same way as an increase in budget outlays. Financing account receipts from the public can be used to finance the payment of the Government's obligations and therefore reduce the requirement for Treasury borrowing from the public in the same way as an increase in budget receipts.

Deposit Fund Account Balances

The Treasury uses non-budgetary accounts, called deposit funds, to record cash held temporarily until ownership is determined (for example, earnest money paid by bidders for mineral leases) or cash held by the Government as agent for others (for example, State and local income taxes withheld from Federal employees' salaries and not yet paid to the State or local government or the Thrift Savings Fund, a defined contribution pension fund held and managed in a fiduciary capacity by the Government). Deposit fund balances may be held in the form of either invested or uninvested balances. To the extent that they are not invested, changes in the balances are available to finance expenditures and are recorded as a means of financing other than borrowing from the public. To the extent that they are invested in Federal debt, changes in the balances are reflected as borrowing from the public in lieu of borrowing from other parts of the public and are not reflected as a separate means of financing.

Exchanges with the International Monetary Fund (IMF)

Under the terms of its participation in the IMF, the U.S. transfers dollars to the IMF and receives Special Drawing Rights (SDR's) in return. The SDR's are interest-bearing monetary assets and may be exchanged for foreign currency at any time. These transfers are like bank deposits and withdrawals, where the government exchanges one type of financial asset (cash) for another (bank deposit), with no change in total financial assets. Following a recommendation of the 1967 President's Commission on Budget Concepts, the budget excludes these transfers from budget outlays or receipts. In contrast, the budget records interest paid by the IMF on U.S. deposits as an offsetting receipt in the general fund of the Treasury. It also records outlays for foreign currency exchanges to the extent there is a realized loss in dollars terms and offsetting receipts to the extent there is a realized gain in dollar terms.

Railroad Retirement Board Investments

Under longstanding rules, the budget treats investments in non-Federal securities as a purchase of an asset, recording an obligation and an outlay in an amount equal to the purchase price in the year of the purchase. Since investments in non-Federal securities consume cash, fund balances (of funds available for obligation) normally exclude the value of non-Federal securities. However, the Railroad Retirement and Survivors' Improvement Act of 2001 (Public Law 107–90) requires purchases or sales of non-Federal assets by the National Railroad Retirement Investment Trust to be treated as a means of financing in the budget.

Earnings on investments by the National Railroad Retirement Investment Trust in private assets pose special challenges for budget projections. Equities and private bonds earn a higher return on average than the Treasury rate, but that return is subject to greater uncertainty. Sound budgeting principles require that estimates of future trust fund balances reflect both the average return and the cost of risk associated with the uncertainty of that return. (The latter is particularly true in cases where individual beneficiaries have not made a voluntary choice to assume additional risk.) Estimating both of these separately is quite difficult. While the additional returns that these assets have received in the past are known, it is quite possible that these premiums will differ in the future. Furthermore, there is no existing procedure for the budget to record separately the cost of risk from such an investment, even if it could be estimated accurately. Economic theory suggests, however, that the difference between the expected return of a risky liquid asset and the Treasury rate is equal to the cost of the asset's additional risk as priced by the market. Following through on this insight, the best way to project the rate of return on the Fund's balances is to use a Treasury rate. This will mean that assets with equal economic value as measured by market prices will be treated equivalently, avoiding the appearance that the budget could benefit if the Government bought private sector assets.

The actual and estimated returns to private securities are recorded in subfunction 909, other investment income. The actual year returns include interest, dividends, and capital gains and losses on private equities and other securities. The Fund's portfolio of these assets is revalued at market prices at the end of the actual year to determine capital gains or losses. As a result, the Fund's end-of-year balance reflects the current market value of resources available to the Government to finance benefits. Earnings for the current and future years are estimated using the 10-year Treasury rate and the value of the Fund's portfolio at the end of the actual year. No estimates are made of gains and losses for the current year or subsequent years.

Federal Communications Commission Monetary Credit

In June 2000, the Federal Communications Commission (FCC) issued a transferrable monetary credit of $125 million in the form of an Auction Discount Voucher (ADV) to Qualcomm, Incorporated, in satisfaction of a court ruling. The monetary credit was structured to work in a manner similar to that of an auction bidding credit and could be used to bid on spectrum licenses in future FCC auctions. Consistent with the budgetary treatment of other monetary credits, the budget recorded an outlay and borrowing from the public in 2000.

Qualcomm transferred $11 million of the monetary credit in 2002 by using it as an auction bidding credit. In November 2002, the FCC revised its Order governing the ADV to allow Qualcomm to transfer the remaining $114 million to a debtor to repay outstanding direct loans issued for the purpose of purchasing spectrum licenses at previous FCC auctions. In April of 2003, the FCC again revised its Order to grant Qualcomm until June of 2004 to use the remainder of its ADV. During 2003, $59 million was transferred and used against the voucher, leaving an outstanding balance of $56 million.

The $11 million used as an auction bidding credit in 2002 was recorded as an offsetting collection in FCC's Pioneer's Preference Account and then applied to extinguish $11 million of the $125 million FCC debt that was recorded when the Qualcomm voucher was originally issued. The $59 million that was used to repay outstanding loans in 2003 was recorded as offsetting collections in the Spectrum Auction Direct Loan Financing Account and applied to repay outstanding debt of the financing account to Treasury. At the same time, $59 million auction receipts collected by the FCC were reported as offsetting collections in FCC's Pioneer's Preference Account, rather than as general fund receipts, and were applied to extinguish $59 million of the outstanding FCC debt that was recorded when the Qualcomm voucher was issued. The remaining $56 million of vouchers are estimated to be used in 2004, and their use will be recorded in the same way.

FEDERAL EMPLOYMENT

The budget includes information on civilian and military employment. It also includes information on related personnel compensation and benefits. Chapter 23, "Federal Employment and Compensation," provides two different measures of Federal employment levels-actual positions filled and full-time equivalents (FTE). Agency FTEs are the measure of the total number of hours worked by an agency's Federal employees divided by the total number of workhours in one fiscal year. In the budget *Appendix*, only the FTE measure is used because it takes into account part-time employment, temporary employment, and vacancies during the year. (Chapter 23, "Federal Employment and Compensation," provides more information on this subject.)

BASIS FOR BUDGET FIGURES

Data for the Past Year

The past year column (2003) generally presents the actual transactions and balances as recorded in agency accounts and as summarized in the central financial reports prepared by the Treasury Department for the most recently completed fiscal year. Occasionally the budget reports corrections to data reported erroneously to Treasury but not discovered in time to be reflected in Treasury's published data. The budget usually notes the sources of such differences (see Chapter 19, "Comparison of Actual to Estimated Totals" for a summary of these differences).

Data for the Current Year

The current year column (2004) includes estimates of transactions and balances based on the amounts of budgetary resources that were available when the budget was transmitted, including amounts appropriated for the year.

Data for the Budget Year

The budget year column (2005) includes estimates of transactions and balances based on the amounts of budgetary resources that are estimated to be available, including new budget authority requested under current authorizing legislation, and amounts estimated to result from changes in authorizing legislation and tax laws.

The budget *Appendix* generally includes the appropriations language for the amounts proposed to be appropriated under current authorizing legislation. In a few cases, this language is transmitted later because the exact requirements are unknown when the budget is transmitted. The *Appendix* generally does not include appropriations language for the amounts that will be requested under proposed legislation; that language is usually transmitted later, after the legislation is enacted. Some tables in the budget identify the items for later transmittal and the related outlays separately. Estimates of the total requirements for the budget year include both the amounts requested with the transmittal of the budget and the amounts planned for later transmittal.

Data for the Outyears

The budget presents estimates for each of the four years beyond the budget year (2006 through 2009) in order to reflect the effect of budget decisions on longer term objectives and plans.

Medicare Advantage and Drug Plan Premiums

The Medicare Prescription Drug, Improvement, and Modernization Act of 2003 creates two new programs, Medicare Advantage and a prescription drug benefit, which will charge premiums set by private plans. Beneficiaries have the option of paying the premiums through withholding from Social Security benefit payments or by using an electronic funds transfer from their personal bank accounts. Regardless of the method of payment, all premium payments for basic benefits are reported in the budget as offsetting receipts, budget authority and outlays.

Department of Homeland Security

Although resources for the agencies and programs that merged into the Department of Homeland Security were transferred at different points during 2003, the budget presents data for the Department of Homeland Security (DHS) on a three-year comparable basis (i.e., for 2003 through 2005). All the data associated with the DHS components are displayed in the DHS chapter of the budget *Appendix*. The other budget volumes treat DHS similarly.

Allowances

The budget may include lump-sum allowances to cover certain transactions that are expected to increase or decrease budget authority, outlays, or receipts but are not, for various reasons, reflected in the program details. For example, the budget might include an allowance to show the effect on the budget totals of a proposal that would actually affect many accounts by relatively small amounts, in order to avoid unnecessary detail in the presentations for the individual accounts.

Baseline

The budget baseline is an estimate of the receipts, outlays, and deficits or surpluses that would occur if no changes were made to current laws during the period covered by the budget. The baseline assumes that receipts and mandatory spending, which generally are authorized on a permanent basis, will continue in the future as required by current law. The baseline assumes that the future funding for discretionary programs, which generally are funded annually, will equal the most recently enacted appropriation, adjusted for inflation.

The baseline represents the amount of resources, in real terms, that would be used by the Government over the period covered by the budget on the basis of laws currently enacted. (Chapter 24, "Current Services Estimates," provides more information on the baseline.)

The baseline serves several useful purposes:

- It may warn of future problems, either for Government fiscal policy as a whole or for individual tax and spending programs.
- It provides a starting point for formulating the President's budget.
- It provides a "policy-neutral" benchmark against which the President's budget and alternative proposals can be compared to assess the magnitude of proposed changes.

PRINCIPAL BUDGET LAWS

The following basic laws govern the Federal budget process:

- ***Article 1, section 8, clause 1 of the Constitution***, which empowers the Congress to collect taxes.
- ***Article 1, section 9, clause 7 of the Constitution***, which requires appropriations in law before money may be spent from the Treasury.
- ***Antideficiency Act (codified in Chapters 13 and 15 of Title 31, United States Code)***, which prescribes rules and procedures for budget execution.
- ***Chapter 11 of Title 31, United States Code***, which prescribes procedures for submission of the President's budget and information to be contained in it.
- ***Congressional Budget and Impoundment Control Act of 1974 (Public Law 93–344)***, as amended. This Act comprises the:

  – Congressional Budget Act of 1974, as amended, which prescribes the congressional budget process; and

  – Impoundment Control Act of 1974, which controls certain aspects of budget execution.
- ***Balanced Budget and Emergency Deficit Control Act of 1985 (Public Law 99–177)***, as amended, which prescribes rules and procedures (including "sequestration") designed to eliminate excess spending.
- ***Budget Enforcement Act of 1990 (Title XIII, Public Law 101–508)***, which significantly amended key laws pertaining to the budget process, including the Congressional Budget Act and the Balanced Budget and Emergency Deficit Control Act. The Budget Enforcement Act of 1997 (Title X, Public Law 105–33) extended the BEA requirements through 2002 and altered some of the requirements. The requirements generally referred to as BEA requirements (discretionary spending limits, pay-as-you-go, sequestration, etc.) are part of the Balanced Budget and Emergency Deficit Control Act. The BEA expired at the end of 2002.
- ***Federal Credit Reform Act of 1990 (as amended by the Budget Enforcement Act of 1997)***, a part of the Budget Enforcement Act of 1990, which amended the Congressional Budget Act to prescribe the budget treatment for Federal credit programs.
- ***Government Performance and Results Act of 1993***, which emphasizes managing for results. It requires agencies to prepare strategic plans, annual performance plans, and annual performance reports.

GLOSSARY OF BUDGET TERMS

Advance appropriation means appropriations of new budget authority that become available one or more fiscal years beyond the fiscal year for which the appropriation act was passed.

Advance funding means appropriations of budget authority provided in an appropriations act to be used, if necessary, to cover obligations incurred late in the fiscal year for benefit payments in excess of the amount specifically appropriated in the act for that year, where the budget authority is charged to the appropriation for the program for the fiscal year following the fiscal year for which the appropriations act is passed.

Agency means a department or other establishment of the Government.

Allowance means a lump-sum included in the budget to represent certain transactions that are expected to increase or decrease budget authority, outlays, or receipts but that are not, for various reasons, reflected in the program details.

Balances of budget authority means the amounts of budget authority provided in previous years that have not been outlayed.

Baseline means an estimate of the receipts, outlays, and deficit or surplus that would result from continuing current law through the period covered by the budget.

Budget means the Budget of the United States Government, which sets forth the President's comprehensive financial plan for allocating resources and indicates the President's priorities for the Federal Government.

Budget authority (BA) means the authority provided by law to incur financial obligations that will result in outlays. (For a description of the several forms of budget authority, see "Budget Authority and Other Budgetary Resources" earlier in this chapter.)

Budget totals mean the totals included in the budget for budget authority, outlays, and receipts. Some presentations in the budget distinguish on-budget totals from off-budget totals. On-budget totals reflect the transactions of all Federal Government entities except those excluded from the budget totals by law. The off-budget totals reflect the transactions of Government entities that are excluded from the on-budget totals by law. Under current law, the off-budget totals include the Social Security trust funds (Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds) and the Postal Service Fund. The budget combines the on- and off-budget totals to derive unified or consolidated totals for Federal activity.

Budgetary resources mean amounts available to incur obligations in a given year. The term comprises new budget authority and unobligated balances of budget authority provided in previous years.

Cap means the legal limits for each fiscal year under the Budget Enforcement Act on the budget authority and outlays provided by discretionary appropriations.

Cash equivalent transaction means a transaction in which the Government makes outlays or receives collections in a form other than cash or the cash does not accurately measure the cost of the transaction. (For examples, see the section on "Outlays" earlier in this chapter.)

Collections mean money collected by the Government that the budget records as either a receipt, an offsetting collection, or an offsetting receipt.

Credit program account means a budget account that receives and obligates appropriations to cover the subsidy cost of a direct loan or loan guarantee and disburses the subsidy cost to a financing account.

Current services estimate*—see baseline.*

Deficit means the amount by which outlays exceed receipts in a fiscal year. It may refer to the on-budget, off-budget, or unified budget deficit.

Direct loan means a disbursement of funds by the Government to a non-Federal borrower under a contract that requires the repayment of such funds with or without interest. The term includes the purchase of, or participation in, a loan made by another lender. The term also includes the sale of a Government asset on credit terms of more than 90 days duration as well as financing arrangements for other transactions that defer payment for more than 90 days. It also includes loans financed by the Federal Financing Bank (FFB) pursuant to agency loan guarantee authority. The term does not include the acquisition of a federally guaranteed loan in satisfaction of default or other guarantee claims or the price support loans of the Commodity Credit Corporation. (Cf. loan guarantee.)

Direct spending*—see mandatory spending.*

Discretionary spending means budgetary resources (except those provided to fund mandatory spending programs) provided in appropriations acts. (Cf. mandatory spending.)

Emergency appropriation means an appropriation that the President and the Congress have designated as an emergency requirement. Such spending is not subject to the limits on discretionary spending, if it is discretionary spending, or the pay-as-you-go rules, if it is mandatory.

Federal funds group refers to the moneys collected and spent by the Government through accounts other than those designated as trust funds. Federal funds include general, special, public enterprise, and intragovernmental funds. (Cf. trust funds.)

Financing account means a non-budgetary account (its transactions are excluded from the budget totals) that records all of the cash flows resulting from post-1991 direct loan obligations or loan guarantee commitments. At least one financing account is associated with each credit program account. For programs that make both direct loans and loan guarantees, there are separate financing accounts for the direct loans and the loan guarantees. (Cf. liquidating account.)

Fiscal year means the Government's accounting period. It begins on October 1st and ends on September 30th, and is designated by the calendar year in which it ends.

Forward funding means appropriations of budget authority that are made for obligation in the last quarter of the fiscal year for the financing of ongoing grant programs during the next fiscal year.

General fund means the accounts for receipts not earmarked by law for a specific purpose, the proceeds of general borrowing, and the expenditure of these moneys.

Intragovernmental fund*—see revolving fund.*

Liquidating account means a budget account that records all cash flows to and from the Government resulting from pre-1992 direct loan obligations or loan guarantee commitments. (Cf. financing account.)

Loan guarantee means any guarantee, insurance, or other pledge with respect to the payment of all or a part of the principal or interest on any debt obligation of a non-Federal borrower to a non-Federal lender. The term does not include the insurance of deposits, shares, or other withdrawable accounts in financial institutions. (Cf. direct loan.)

Mandatory spending means spending controlled by laws other than appropriations acts (including spending for entitlement programs) and spending for the food stamp program. Although the Budget Enforcement Act uses the term direct spending to mean this, mandatory spending is commonly used instead. (Cf. discretionary spending.)

Means of financing refers to borrowing, the change in cash balances, and certain other transactions involved in financing a deficit. The term is also used to refer to the debt repayment, the change in cash balances, and certain other transactions involved in using a surplus. By definition, the means of financing are not treated as receipts or outlays.

Obligated balance means the cumulative amount of budget authority that has been obligated but not yet outlayed. (Cf. unobligated balance.)

Obligation means a binding agreement that will result in outlays, immediately or in the future. Budgetary resources must be available before obligations can be incurred legally.

Off-budget*—see budget totals.*

Offsetting collections mean collections that, by law, are credited directly to expenditure accounts and deducted from gross budget authority and outlays of the expenditure account, rather than added to receipts. Usually, they are authorized to be spent for the purposes of the account without further action by Congress. They result from business-like transactions or market-oriented activities with the public and other Government accounts. The authority to spend offsetting collections is a form of budget authority. (Cf. receipts and offsetting receipts.)

Offsetting receipts mean collections that are credited to offsetting receipt accounts and deducted from gross budget authority and outlays, rather than added to receipts. They are not authorized to be credited to expenditure accounts. The legislation that authorizes the offsetting receipts may earmark them for a specific purpose and either appropriate them for expenditure for that purpose or require them to be appropriated in annual appropriation acts before they can be spent. Like offsetting collections, they result from business-like transactions or market-oriented activities with the public and other Government accounts. (Cf. receipts, undistributed offsetting receipts, and offsetting collections.)

On-budget*—see budget totals.*

Outlay means a payment to liquidate an obligation (other than the repayment of debt principal). Outlays generally are equal to cash disbursements but also are recorded for cash-equivalent transactions, such as the issuance of debentures to pay insurance claims, and in a few cases are recorded on an accrual basis such as interest on public issues of the public debt. Outlays are the measure of Government spending.

Outyear estimates means estimates presented in the budget for the years beyond the budget year (usually four) of budget authority, outlays, receipts, and other items (such as debt).

Pay-as-you-go (PAYGO) means the requirements of the Budget Enforcement Act that result in a sequestration if the estimated combined result of legislation affecting mandatory spending or receipts is a net cost for a fiscal year.

Public enterprise fund*—see revolving fund.*

Receipts mean collections that result from the Government's exercise of its sovereign power to tax or otherwise compel payment and gifts of money to the Government. They are compared to outlays in calculating a surplus or deficit. (Cf. offsetting collections and offsetting receipts.)

Revolving fund means a fund that conducts continuing cycles of business-like activity, in which the fund charges for the sale of products or services and uses the proceeds to finance its spending, usually without requirement for annual appropriations. There are two types of revolving funds: Public enterprise funds, which conduct business-like operations mainly with the public, and intragovernmental revolving funds, which conduct business-like operations mainly within and between Government agencies.

Scorekeeping means measuring the budget effects of legislation, generally in terms of budget authority, receipts, and outlays for purposes of the Budget Enforcement Act.

Sequestration means the cancellation of budgetary resources provided by discretionary appropriations or mandatory spending legislation, following various procedures prescribed by the Budget Enforcement Act. A sequestration may occur in response to a discretionary appropriation that causes discretionary spending to exceed the discretionary spending caps set by the Budget Enforcement Act or in response to net costs resulting from the combined result of legislation affecting mandatory spending or receipts (referred to as a "pay-as-you-go" sequestration).

Special fund means a Federal fund account for receipts or offsetting receipts earmarked for specific purposes and the expenditure of these receipts. (Cf. trust fund.)

Subsidy means the estimated long-term cost to the Government of a direct loan or loan guarantee, calculated on a net present value basis, excluding administrative costs and any incidental effects on governmental receipts or outlays.

Surplus means the amount by which receipts exceed outlays in a fiscal year. It may refer to the on-budget, off-budget, or unified budget surplus.

Supplemental appropriation means an appropriation enacted subsequent to a regular annual appropriations act, when the need for funds is too urgent to be postponed until the next regular annual appropriations act.

Trust fund refers to a type of account, designated by law as a trust fund, for receipts or offsetting receipts earmarked for specific purposes and the expenditure of these receipts. Some revolving funds are designated as trust funds, and these are called trust revolving funds. (Cf. special fund and revolving fund.)

Trust funds group refers to the moneys collected and spent by the Government through trust fund accounts. (Cf., Federal funds group.)

Undistributed offsetting receipts mean offsetting receipts that are deducted from the Government-wide totals for budget authority and outlays instead of offset against a specific agency and function. (Cf. offsetting receipts.)

Unobligated balance means the cumulative amount of budget authority that is not obligated and that remains available for obligation under law.

User charges are charges assessed for the provision of Government services and for the sale or use of Government goods or resources. The payers of the user charge must be limited in the authorizing legislation to those receiving special benefits from, or subject to regulation by, the program or activity beyond the benefits received by the general public or broad segments of the public (such as those who pay income taxes or custom duties).

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